In the Supreme Court of the United States

October Term, 1952

No. 150

Western Pacific Railroad Corporation and Alexis I. du P. Bayard, Receiver,

Petitioners,

vs.

Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, The Western Realty Company, The Standard Realty and Development Company and Delta Finance Co., Ltd.,

Respondents.

Brief for Petitioners

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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B. The Respondent Conceived the Tax Saving, Took Over and Handled Petitioner's Tax Affairs, Appropriated Petitioner's Tax Credits in Order to Accomplish the Tax Saving, and Ignored Its Fiduciary Relation to Petitioner by Refusing to Account.

We have just related the bare facts of how respondent received a benefit of $17 million through the use of petitioner's loss. Under principles to be discussed in the Argument, these facts, without more, entitle petitioner to judgment.

But beyond that, the manner in which the transaction was handled, the relationship of the parties, the resulting duties and obligations, not only fortify petitioner's claim but furnish an independent ground of recovery.

The taxes were saved through a method conceived, planned and executed by respondent while occupying a fiduciary relation to petitioner in disregard of its fiduciary obligations. Under the law and the Treasury regulations, consolidated returns must be filed in the name of the parent corporation, claims for refund are filed in its name, and all refunds are payable to it. Respondent used petitioner for its own purposes, without any consideration for petitioner's rights. It was able to do this because it controlled Curry, petitioner's president and actually its only officer. As described by the trial court, Curry was "just a presiding officer and a sort of figurehead" (R. 646, 647).

1. SUMMARY OF THE FACTS.

One week after this Court's decision on March 15, 1943, respondent employed the firm of Whitman, Ransom, Coulson and Goetz (attorneys for the James Interests) as its tax attorneys. One of the partners was Polk, who had formerly been employed in the Bureau of Internal Revenue. He con-

ceived the plan of using petitioner's loss to cancel respondent's tax liability. He convinced respondent of the possibility of success of his plan, obtained its authority to proceed, and carried through his plan. He was employed, directed and compensated solely by respondent, and never gave petitioner any advice as to its rights.

Petitioner was in an impoverished condition following this Court's decision of March 15, 1943. It could not even pay officers' salaries. Its officers were taken over as "full time employees" by respondent on July 1, 1943, before the tax returns were filed, and continued as such until May 1, 1945, when Mr. Curry, petitioner's president, accompanied by petitioner's files, was moved to Polk's office to be available for these tax matters, ostensibly as an employee of Polk's firm but actually compensated by respondent.

Pursuant to his plan Polk used these officers to file consolidated tax returns in petitioner's name and caused its loss to be offset against respondent's income, without knowledge of petitioner's Board of Directors. Polk obtained from Curry a document naming him petitioner's 'attorney-in-fact'. Without petitioner's knowledge, but only after specific authorization of respondent, he made and carried through an offer of settlement with the Treasury in petitioner's name as its "attorney-in-fact".

2. STATEMENT OF THE FACTS.

Petitioner's Stunned Condition.

Respondent Polk, and all connected with the transaction, considered petitioner a dying corporation and gave no consideration whatever to its rights.

After this Court's decision of March 15, 1943, petitioner was, to select an appropriate metaphor, in a state of coma,

CHRONOLOGY

1916		Petitioner invests $75 million for entire stock of respondent railroad.
1935		Respondent goes into bankruptcy under Sec. 77B—Trustees appointed.
1939		I.C.C. approves plan of reorganization of respondent excluding petitioner's stockholding as worthless.
1943		
Mar.	15	Supreme Court approves I.C.C. Reorganization Plan.
Mar.	23	Coulson firm employed as Tax Counsel for respondent.
May	15	1942 consolidated tax returns filed for petitioner and respondent.
June	1	Petitioner's president, secretary and employees taken over as full time employees of respondent.
Oct.	11	District Court confirms I.C.C. Plan.
1944		
Jan.	11	Coulson opinion letter advising respondent that petitioner's stock loss could be used to offset respondent's income.
Mar.	3	Respondent's 1943 tax accruals reversed and $7,100,000 placed in contingent tax reserve.
Apr.	30	Income tax affiliation terminated.
July	15	1943 consolidated tax returns filed with petitioner's loss used to offset respondent's income.
Dec.	14-29	Railroad revested in respondent and Assumption Agreement executed by it assuming liabilities of Trustees.
1945		
Mar.	9	Refund Claim for 1942 taxes filed, based on petitioner's loss.
Mar.	26	Additional $3 million placed in contingent tax reserve by respondent.
May	1	New York offices closed. Curry and Valouch, petitioner's president and secretary, go to Coulson's office on his payroll.
June	15	1944 consolidated tax returns filed, with petitioner's loss used to offset respondent's income.
1946		
Oct.	10	This suit filed.
1947		
Feb.	11	First offer of tax settlement.
Aug.	13-28	Tax settlement with Government. Respondent's $10,100,000 funded contingent tax reserve transferred to reserve to meet any judgment in this suit.
Dec.	17	Supplemental complaint filed.

In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 150

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. DUP. BAYARD, RECEIVER,

Petitioners,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY AND DELTA FINANCE CO., LTD.,

Respondents.

Brief for Petitioners

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the District Court (R. 258) is reported in 85 F. Supp. 868. The opinion of the Court of Appeals (R. 2214), a dissenting opinion (R. 2239), the opinion of the

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All emphasis is supplied unless otherwise indicated.

References to pages of the record are shown by the page number in parentheses: (R.).

Exhibits are indicated thus: Plaintiff's (P); Defendants' (D.), the number of the exhibit following the letter.

Court striking the petition for rehearing in banc (R. 2260), the opinion of Fee, J., suggesting a rehearing by all the circuit judges (R. 2261), the opinion of the Court in banc denying leave to reinstate the petition for rehearing in banc (R. 2288), and a dissenting opinion (R. 2296) are reported in 197 F.2d 994. A supplement to the last dissenting opinion (R. 2313) has not yet been reported.

JURISDICTION

The District Court had jurisdiction under 28 U.S.C., Sec. 1331, 1332, and the Court of Appeals under 28 U.S.C., Sec. 1291 and 1294(1). That court's judgment was entered October 29, 1951 (R. 2255). On December 17, 1951, within the time allowed by order (R. 2257-9), a petition for rehearing and a petition for rehearing in banc were filed (R. 2259-60). On January 30, 1952, the petition for rehearing was denied, and the petition for rehearing in banc was ordered stricken as without authority in law or in the rules of practice of the court (R. 2259). On April 19, 1952, by order of Mr. Justice Douglas petitioner's time to file a petition for certiorari was extended to June 27, 1952. The petition for a writ of certiorari was filed June 23, 1952, and granted October 13, 1952. The jurisdiction of this Court rests on 28 U.S.C., Sec. 1254(1).

QUESTIONS PRESENTED

1. Must a former parent corporation join in consolidated federal income and excess profits tax returns with its former subsidiary, so that a loss incurred by the former parent may be used to extinguish the tax liability of its former subsidiary, without any accounting by the former subsidiary

to the former parent for the benefit thus obtained? The loss so utilized was the parent's loss of its entire investment in the subsidiary (I.R.C., Sec. 23(g)(2) and (4)).

2. Does not a Court of Appeals exceed its appellate office and so far depart from the accepted and usual course of judicial proceedings as to call for this Court's power of supervision (Supreme Court Rule 38(5)(b)), where it finds facts *ab initio* to affirm a judgment which it holds to be non-sustainable on either the legal theories applied or the facts found by the trial court, particularly where its findings are contrary to those which the trial court made clear it would have found had it considered the issues material?

3. May a litigant petition a Court of Appeals for a rehearing in banc under 28 U.S.C. Sec. 46(c) after decision by a three-judge panel; or may two judges of the panel strike out such petition "as being without authority in law or in the rules or practice of this court", thus preventing the petition from being considered by the court of seven judges?

STATUTES INVOLVED

The pertinent provisions of Internal Revenue Code, Section 23(g)(2) and (4), 52 and 141, Treasury Regulation 104, Title 28 U.S.C., Sec. 46(c), and R.C.P. 52(a), are printed in Appendix One hereto.

STATEMENT OF THE CASE

Throughout this brief the term "petitioner" will be used to denote The Western Pacific Railroad Corporation, the plaintiff in the District Court. The term "respondent" will denote The Western Pacific Railroad Company, the principal defendant.

Petitioner seeks to compel respondent to account for a $17,201,739 federal tax benefit derived from respondent's use of a right belonging to petitioner. Respondent obtained that benefit by causing consolidated income and excess profits tax returns to be filed by petitioner and by using in those returns a $75 million loss of petitioner to offset respondent's taxable income. Thereby taxes otherwise payable by respondent were discharged. As the trial court found and the Court of Appeals repeated, the amount of the tax benefit so obtained by respondent from its use of petitioner's loss was $17,201,739 (R. 267, 2217-18). For convenience, this will be referred to as $17 million.[1]

The co-petitioner, Mr. Bayard, is the receiver of petitioner, appointed in October 1949 by the Chancery Court of Delaware on the petition of the Attorney General of that state for the purpose of realizing on all of petitioner's assets and claims (R. 292). The receiver was then joined as a party plaintiff in the present case (R. 317), was one of the appellants (R. 326), and is a co-petitioner here. The term "petitioner" in this brief includes the receiver after November 1949 unless the context shows otherwise.

The real parties in interest on petitioner's side are its 4,700 stockholders, living throughout the United States,

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[1]Six additional companies were named as defendants and are respondents here but for practical purposes may be ignored. Four were and are wholly owned subsidiary companies of the principal defendant. Another, Western Realty Company, was wholly owned by petitioner. The sixth was wholly owned by Western Realty and is now wholly owned by the principal defendant. These companies were joined as defendants merely because they were parties to the consolidated income tax returns; no relief was sought against them.

The corporate relationships are shown on a chart (P 1). Printing of this exhibit in the record was dispensed with by order of the court, but it is reproduced at the end of this brief.

more than 1,000 of them in California (R. 659). They had invested $110 million in petitioner's stock.[2] It in turn had invested over $75 million in the stock of respondent, and it was the loss of that stock which created the loss which respondent used to discharge its taxes.

Any recovery by petitioner will go to the receiver for distribution to petitioner's preferred stockholders[3] under the Delaware Chancery Court's supervision.

The petitioners in No. 160, a case companion to this, were interveners below. They were stockholders of petitioner who had filed a stockholders' suit in New York against it and its directors, alleging (among other things) that the directors had failed to protect and enforce petitioner's interest in connection with the use of its loss in the tax returns mentioned above. Thereafter, petitioner brought this suit in California, and these stockholders were permitted to intervene. This was prior to the appointment by the Chancery Court of Delaware of Mr. Bayard as receiver and his joinder as co-plaintiff here. The interveners present no claims of their own, and their interest is identical with that of petitioner.

The District Court rendered judgment for respondent although it found the facts to be as contended by petitioner. On appeal the Court of Appeals, composed of one Circuit Judge and two District Judges, found the District Court's legal theories to be erroneous but affirmed the judgment on a different legal theory. Judge Fee dissented.

The decisions of the two courts are more fully described at pages 36-38 below, after the facts have been stated.

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[2] P 4B, Schedule C; printing of this exhibit was also dispensed with by order.

[3] The preferred stock exceeds the amount recoverable in this suit (R. 1717).

A. Petitioner's Loss: How It Came About; the Economic Unity of Petitioner and Respondent and Its Severance.

Until April 30, 1944, petitioner owned all of the capital stock of respondent, an operating railroad company. For this stock petitioner had invested $75 million in respondent (R. 262).

In 1935, the respondent went into bankruptcy under Section 77 of the Bankruptcy Act[4] (R. 1908). Trustees were appointed on September 23, 1935 (R. 1916), and remained in possession until December 29, 1944. The term "respondent" or "Company" as used in this brief includes the trustees during that period.

On June 21, 1939, the Interstate Commerce Commission approved a plan of reorganization, which found that petitioner's stock in respondent was without equity or value and was not entitled to participate in the reorganization.[5] The bankruptcy court approved the Commission plan (R. 1666). On November 28, 1941 the Ninth Circuit reversed,[6] but on March 15, 1943, this Court affirmed the bankruptcy court's approval of the plan.[7]

THE TWOFOLD CONSEQUENCES OF THIS COURT'S DECISION OF MARCH 15, 1943.

Following this Court's decision, the reorganization plan was confirmed by the bankruptcy court on October 11, 1943 (R. 1674). The consequences were twofold.

First, this Court's decision of March 15, 1943 established that petitioner's entire $75 million investment in respondent

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[4] 11 U.S.C., Sec. 205.

[5] *Western Pacific R. Co. Reorganization*, 233 I.C.C. 409, 452.

[6] *In re Western Pacific R. Co.*, 124 F.2d 136 (9 Cir.).

[7] *Ecker v. Western Pacific R. Corp.*, 318 U.S. 448.

was worthless and confirmed its loss in that amount. Petitioner had no other substantial assets.[8]

Second, the economic unity which had previously existed between petitioner and respondent was severed forever, and they became economic strangers. The proprietary interest of petitioner in respondent was at an end; the community of economic interest was over.

For the purpose of determining the relative rights and duties of the parties this Court's decision marks the date of the loss. It then became the duty of the District Court (in the absence of some unusual circumstances) to confirm the plan if the requisite percentage of creditors voted in favor of it and probably even if they did not.[9] The James Interests, the largest stock interest in both petitioner and respondent (R. 1717; Chart, P 1), had previously fought the plan and sought to maintain petitioner's equity in respondent.[10] But immediately after this Court's decision the James Interests decided to support the plan and entered into an agreement with other major creditors to work wholeheartedly for its prompt consummation (R. 577, 578, 618).

For tax purposes it is immaterial whether petitioner's loss was in March or October, 1943, for in either event it is a 1943 loss. But for the purpose of fixing the relative rights, duties and obligations of the parties, the date of March 15, 1943 is important.

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[8]Substantially all its remaining assets consisted of stock of the Denver & Rio Grande Western Railroad Company. The investment in the latter was wiped out by a plan of reorganization of that railroad (R. 575); see *R.F.C. v. Denver & R. G. W. R. Co.*, 328 U.S. 495.

[9]Bankruptcy Act, Sec. 77(e); 11 U.S.C., Sec. 205(e).

[10]For the identity of the James Interests, cf. pp. 15, 16, infra, and Chart, P 1, reproduced at the end of this brief.

HOW THE TAX BENEFIT WAS OBTAINED.

Under the Internal Revenue Code,[11] a parent company and its subsidiaries may file a consolidated tax return in which losses of all are offset against gains of all, and taxes are paid only on the net. In October 1942 Section 23(g)(4), I.R.C. was amended so as to provide for the first time that a loss arising from worthlessness of stock in a subsidiary is an ordinary rather than a capital loss and thus deductible from taxable income.[12]

As just noted, this Court's decision of March 15, 1943, fixed the date when petitioner sustained a $75 million loss, and, at the same instant, its financial interest in respondent terminated and it became a complete economic stranger. In this state of facts respondent's tax counsel conceived the plan of having petitioner and respondent file consolidated returns in order to set off the petitioner's loss against respondent's income, and thus discharge respondent's tax liabilities.

This respondent then caused to be done.

Respondent made large profits in the war years of 1942, 1943 and 1944, at which time the excess profits tax was in effect. Taxable net profits were nearly $11 million in 1942, over $18 million in 1943, and in 1944 up to April 30th nearly $3 million (P 3, 4, 5). Throughout 1943 and the first four months of 1944 respondent made accruals of $10,100,000 to meet its anticipated tax liability (R. 915, 1818-1824).

[11]Internal Revenue Code, Sec. 141; Treasury Regulation 104, relative to income taxes, and Regulation 110, relative to excess profits taxes. Regulations 104 and 110 were merged into Regulation 129, applicable to tax years beginning December 31, 1949. We shall therefore refer to 104 and 110, since they were in effect during the years here involved.

[12]Revenue Act of 1942, Sec. 123(a), adding subsection 4 to Section 23(g), I.R.C.

Consolidated income and excess profits tax returns for 1943 were filed in petitioner's name on July 15, 1944 (P 4A and B). They reported petitioner's stock loss of $75 million sustained in 1943, used $18 million of it to offset that amount of respondent's taxable net income, and thus reported no net income and no tax due.

The unused portion of the loss could be carried forward and back (I.R.C., Sec. 122(b)(1) and (2)). On March 9, 1945, respondent's tax counsel filed a claim for refund in petitioner's name to recover the $4,201,821 paid as respondent's 1942 taxes (R. 1656), the basis of the claim being the use as a carryback of over $10 million of the unused portion of petitioner's 1943 loss. And on June 15, 1945 respondent's tax counsel filed consolidated returns in petitioner's name for the period January 1-April 30, 1944 (P 5A, 5B), offsetting against nearly $3 million of respondent's income another portion of petitioner's loss, thus reporting no tax due.

In 1947, the taxes were finally settled by agreement with the Treasury Department on the basis of the returns as filed, the 1943 and 1944 taxes being nil, and the claim for refund for 1942 being rejected (see further detail at pp. 23-26, infra). The net tax benefit accruing to and retained by respondent from the use of petitioner's stock loss was $17,201,739 (R. 267).

The question before this Court is whether petitioner and its stockholders, who provided the capital which was lost and who sustained the loss, are entitled to an accounting by respondent of the benefit obtained by it through its use of that loss.

stunned by the misfortunes heaped upon it. It had lost its chief asset, its $75 million investment in the respondent. Its other assets were pledged to secure loans then in default (R. 571-573; also R. 1767, 1768, 1695-98). Consequently, in March 1943, its directors were contemplating dissolution and so advised its chief creditors, including the James Interests (R. 571). The James Interests would be the controlling interest in the reorganized respondent (Corporate Relationship Chart, P Ex. 1), and they were represented by Mr. Coulson, Polk's partner.

Petitioner's Delaware franchise taxes were in default, but Polk considered it essential that it remain in existence until the reorganization was consummated (R. 1764). Funds to pay these taxes were then provided by the James Interests (R. 713).

Petitioner's Lack of Independent Representation.

The positions occupied during the critical period by those who were directors or officers of petitioner and respondent are shown by plaintiff's Exhibit 2A, which we reproduce at the end of this brief.[13]

Prior to June 1, 1943, petitioner had maintained its offices jointly with those of the respondent and the Trustees in New York. Its officers were also employees of respondent, and their salaries and the expenses of the office had been jointly paid.

As of June 1, 1943, petitioner was incapable of further paying salaries or office expenses. Thereupon all of the officers and employees of the New York office, including

[13]Printing of this exhibit in the record was dispensed with by order.

petitioner's president and secretary, were taken over by respondent by decision of its president. In his words, they became its "full time" employees (R. 1738). This situation continued until respondent's New York offices were closed on May 1, 1945, at which time petitioner's president and secretary, accompanied by petitioner's files, were moved to the offices of respondent's tax counsel and thenceforth received their compensation from them, they being ultimately reimbursed by respondent (R. 1735, 1738).

From June 1, 1943, until this suit was filed in October 1946, nine persons were at one time or another directors of petitioner. With three exceptions (Messrs. Osborn, Wood and Hatton), every one of them was an employee of respondent from which they received their livelihood, and one of them, Mr. Schumacher, was not only a director and Chairman of the respondent's Executive Committee but was also one of its trustees in bankruptcy.

Of the three who were not employees of respondent and who did not receive compensation from it, one of them, Mr. Osborn, was a director of respondent and another, Mr. Hatton, was a clerk in the employ of the Denver & Rio Grande Western Railroad and as such recognized Mr. Schumacher as his superior and chief, for Mr. Schumacher was an officer of that company (R. 1135). Three of the nine were clerks in respondent's employ—Miss Sheehan, switchboard operator; Mr. Wienken, stenographer; Miss Valouch, stenographer and clerk. Miss Sheehan and Mr. Hatton were put on the board to make up a quorum (R. 1138, 1139), and Miss Valouch did not become a director until the day the New York office was closed, when she became a regular employee of respondent's tax counsel.

Of the entire group of directors, none—other than Mr. Wood and Mr. Osborn—had the capacity, business experience or financial independence to give competent disinterested attention to petitioner's affairs in any matter wherein respondent could have an adverse interest. Yet not until shortly before the present suit was filed in October, 1946, did either Wood or Osborn ever know or was either advised that petitioner's stock loss was being used in tax returns or that thereby respondent was saving taxes; neither knew or was advised of the legal or economic consequences of the filing of the returns involved in this case (Wood, R. 1129, 1132; Osborn, R. 1019, 1022).[14]

Meanwhile, petitioner had, actually, only one officer, Mr. Curry. Mr. Curry was a competent chief clerk, and he so regarded himself (R. 639, 646, 647, 736, 756). When Mr. Schumacher retired as petitioner's president, primarily because of petitioner's financial distress (R. 644, 645, 743), there was "nothing facing us but liquidation and dissolution * * * he [Schumacher] felt I [Curry] could carry through", and Mr. Curry was therefore, on February 1, 1942, appointed president and treasurer (R. 743). He was, at the same time, an employee of the respondent, its vice president, assistant secretary, assistant treasurer, a director and a member of its executive committee.

[14] Wood and Osborn were under the impression that consolidated returns were being filed, but they did not know of the use of petitioner's stock loss. The idea of using the loss in such returns was considered by Polk, respondent's tax counsel, as a mere speculation of a possibility when he first thought of it in May, 1943, "commented on rather than suggested * * * since it is paradoxical," and for that reason not recommended to be used until December, 1943 (R. 1448, 1484) and never brought home to Wood or Osborn.

After June 1, 1943, although Mr. Curry continued as petitioner's president, he received no compensation from it (R. 645) and thereafter received his livelihood from respondent until May 1, 1945 (R. 1729-33) when he went on pension from the respondent (R. 530, 532) and a retainer from its tax counsel at its ultimate expense (R. 1744, 1749). He did not consider that he had any understanding of, or competence in, tax matters and relied implicitly on tax counsel for respondent. "Tax matters were wholly Greek to me", he testified (R. 808).

The trial court observed Mr. Curry on the witness stand and summed up its estimate of him and of the significance of his testimony by describing Curry as "just a presiding officer and a sort of figurehead". Curry responded, "I admit that this is so" (R. 646, 647). He was a signing officer and "signed whatever documents they told you to sign" (R. 642).

Messrs. Coulson and Polk.

A description of what was done requires an identification of Mr. Coulson and his partner, Mr. Polk, and of the James Interests.

From 1925 until his death in 1941, Mr. Arthur Curtiss James and his wholly owned companies owned 8.8% of petitioner's preferred stock and 61% of its common stock (Chart, R. 1). Mr. Coulson and his firm (Whitman, Ransom, Coulson and Goetz) were attorneys for Mr. James and his companies and were and are attorneys for all the James Interests, including the James Foundation of which Mr. Coulson is a trustee (R. 536).

James died in 1941, and after this Court upheld the plan of reorganization on March 15, 1943, Mr. Coulson and the

James Interests decided to cast their lot with respondent, although as a major creditor they could still have voted against the plan (R. 577, 578).[15]

The common stockholdings of the James group in petitioner became worthless when the plan was approved by this Court. On the other hand, their securities in respondent gave them stock and convertible bonds of the reorganized respondent, for both of which they ultimately received 28% of its stock (Chart, P 1).

Mr. Coulson Introduced Himself Into the Parties' Tax Matters, February 1943, and His Firm Became Tax Counsel for the Respondent March 1943.

On February 24, 1943, three weeks before this Court's decision, when his firm was not tax counsel for either petitioner or respondent, Mr. Coulson introduced himself into their federal tax matters by writing to respondent's president for tax information (R. 537). He did so on behalf of the James Interests (R. 538) because, so he testified, the effect of taxes on respondent was of vital concern to the James Interests (R. 965). Disturbed by the reply, on March 15th, the day of this Court's decision, he asked his partner, Mr. Polk, to look into the situation, stating (R. 539):

> "Actually, I happen to know that the only person over at the corporation [petitioner's] office here in New York who has any knowledge of taxes is a girl who is primarily Schumacher's secretary * * * I would be a little surprised if the report were intelligently prepared."

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[15] Mr. James' allegiance during his lifetime lay with petitioner; he sought to save its equity in the respondent and was active in resisting the plan of reorganization of the Interstate Commerce Commission which denied that equity (R. 536).

Polk replied that "Only the lady referred to [Valouch] had any part in the preparation of the return * * *. Mr. Curry says they are too impoverished to hire accounting help." (R. 540)

Eight days later, on March 23, 1943, Mr. Coulson and his firm became tax counsel for the Trustees and the respondent, and the actual work was delegated to Mr. Coulson's law partner, Polk, who specialized in tax matters (R. 543-6).

Messrs. Coulson and Polk and their firm obtained all their compensation and received all their instructions from respondent,[16] but they conducted themselves as attorneys at law and attorneys-in-fact for petitioner as well.

Petitioner Was Under No Duty Under the Tax Laws to File Consolidated Returns.

Under the law and the regulations, only the parent corporation can file consolidated returns (Reg. 104, Sec. 23.16 (a)). The fact that a consolidated return has been filed in one year gives rise to no duty or obligation to file such a return in a subsequent year, if the law or regulations have been so changed as to make it less advantageous (Reg. 104, Sec. 23.11(a)). In that case separate returns may be filed.

Each of the years 1942, 1943 and 1944 was one in which any member of an affiliated group was free to file separate returns, irrespective of whether consolidated returns had been previously filed (II Montgomery's Federal Taxes, Cor-

[16]On November 15, 1948, Coulson rendered a final statement to respondent "covering professional services in the tax disputes as to the taxable period January 1, 1942 through April 30, 1944" in the amount of $300,000. At the same time he also rendered a bill to respondent for the retainer payments to Curry, petitioner's president, for the period July 1, 1945 to December 31, 1948, in the amount of $10,500 (R. 1749). These respondent paid.

porations and Partnerships, 1946-7, pp. 649, 650). And at the time each return in question here was filed, there existed the right in petitioner not to file a consolidated return if it was so advised. Unless the respondent could become a party to consolidated returns with plaintiff, it would have to file or pay taxes on the basis of separate returns. Mr. Polk was aware of these facts (R. 1458).

Prior to this Court's decision tentative returns on a consolidated basis had been filed for 1942 and an extension obtained until May 15, 1943 for the final returns. Under the regulations, the filing of a tentative consolidated return did not preclude filing the final returns on a separate basis (Reg. 104, Sec. 23.10(b)). Whether the final return should be a consolidated one was one of the first questions considered by Mr. Polk (R. 544).

The severance of the economic unity between petitioner and respondent took place between the filing of the tentative returns and the filing of the final returns for 1942.

1942 Tax Returns.

Without calling any of these factors to petitioner's attention, Mr. Polk decided that it was in the interest of respondent that consolidated returns should be filed (Polk, R. 1444, Coulson, R. 1482). He had these returns prepared and placed before Mr. Curry, vice president of the respondent and president of the petitioner, for signature. Mr. Curry had been informed by Mr. Schumacher that Mr. Polk was tax counsel for both companies (R. 660). When the returns were laid before him for signature, he therefore inquired whether they had Mr. Polk's approval. Being informed that they had, he signed without consulting or advising the

petitioner's board of directors and without being advised by Mr. Polk or anyone else that petitioner did not have to file consolidated returns (R. 663, 664).

The 1943 Returns: The Decision to Use Petitioner's Stock Loss Was Made by Respondent.

The use of a loss of the character of petitioner's as an ordinary, rather than a capital, loss was first made possible by the October 1942 amendment to the Revenue Act. The idea of using petitioner's stock loss occurred to Mr. Polk in May 1943. In a letter to Mr. Curry as vice president of respondent, on May 20, 1943, he stated it to be a mere speculation of a possibility and was "commented on rather than suggested * * * since it is paradoxical" ("paradox letter," R. 588, P. 50). Polk sent no advice of it to petitioner. The "paradox" lay in the fact that the loss to be used to enable respondent to avoid taxes arose from the very fact that petitioner was cut off by the bankruptcy from any further economic interest in the respondent and could gain no benefit as a stockholder from the discharge of respondent's taxes.

In December 1943, Mr. Polk first decided to advise the use of the petitioner's stock loss (Polk, R. 1448; Coulson, R. 1484). When he came to that conclusion, he did not advise petitioner or Mr. Curry. Instead, he went to San Francisco to discuss the tax matters with respondent's officers, the agents of the reorganization trustees, and in January 1944 he recommended to them the filing of consolidated returns and the use of petitioner's loss (R. 1448, 1484), although he refused to advise that respondent could "bank" on the Treasury's allowing the deduction.[17] Without

[17] Mr. Elsey, respondent's president, testified that (R. 1268), "Mr. Polk advised me that we were within our legal right in taking

advising or consulting petitioner, he told respondent's president, that "We [the respondent] were within our legal right in taking the corporation's stock loss as a deduction in our consolidated return" (R. 1268).

The decision to use petitioner's loss was made in San Francisco by respondent's president, in January 1944 (R. 1448, 1484). He insisted on a written opinion to protect him (R. 1268), and such an opinion, dated January 11, 1944, signed by Mr. Coulson, was addressed to him as president of respondent. Petitioner was not consulted. Nevertheless, the opinion stated flatly,

> "Accordingly, there will be allowed in the consolidated return a loss to the parent company of approximately the cost of the railroad company stock. This loss however computed would appear to far exceed the incomes of the other members of the affiliated group. Accordingly, for the year 1943 on a consolidated return basis there would appear to be no excess profit tax or income tax liability." (R. 605, at 609, 610).

A copy of this letter was sent to Mr. Schumacher as one of respondent's Trustees (R. 613, 614). But no one sent a copy to the petitioner or advised it (R. 665). Respondent's annual report for 1943, issued May 1, 1944, 2½ months before the returns for 1943 were filed, contained a statement that "A consolidated tax return for 1943 can and will be filed by the holding company" (R. 512). This determination that the petitioner "will" file a consolidated re-

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the corporation's stock loss as a deduction in our consolidated return. * * * I was very much surprised at that statement, and asked him if I could bank on it. He said no, that that matter will not be finally decided until the Treasury Department completes their audit on our '43 returns." Note that in this conversation petitioner's loss is treated as though it belonged to respondent.

turn was not made by it but by respondent without consultation with petitioner. The decision was made in the office of respondent's president (R. 1277, 1278, 1450).

In due course the 1943 returns were prepared under Mr. Polk's direction and were laid before Mr. Curry for signature as president of petitioner. Mr. Curry had had no part in their preparation, but, being assured that Mr. Polk approved them, he signed, again without consulting petitioner's board of directors and without being advised that petitioner need not file a consolidated return if it did not wish to do so (R. 663-665).

1942 Refund Claim Based on Carry-Back of Petitioner's Loss.

In March 1945, the claim for refund of 1942 taxes based on the carry-back of petitioner's loss was prepared by Mr. Polk on his own initiative and without discussing it with any representative of petitioner. Mr. Polk sent it to Mr. Curry with the request that he sign it as petitioner's president (R. 1418, 1450, 1451), and Mr. Curry, being told that Mr. Polk wanted him to sign, did so, again without consulting petitioner's board of directors (R. 667).

1944 Tax Returns:—Mr. Curry in Mr. Coulson's Office.

Late in 1944, Mr. Polk decided to recommend consolidated returns for the first four months of 1944, again using petitioner's loss (R. 1486). He so advised respondent (R. 623). But petitioner was not advised about this decision. The decision to file such consolidated returns was made by respondent (R. 1450).

These returns were not filed until June 1945. By that time Mr. Curry was occupying office space with Mr. Coul-

son's firm. On May 1, 1945, respondent's New York offices had been closed and all employees let out. On April 21, 1945, in anticipation of that event, Mr. Coulson wrote respondent's president to obtain approval of retaining Mr. Curry at $3000 per year; Mr. Coulson wished to hire petitioner's president for the purpose of serving respondent's interests in the tax matters here involved (R. 1496). He wrote,

> "As president of the old holding company [petitioner] which is a party in interest (without financial stake) in the consolidated return period, it seems to us essential that we have Mr. Curry available to secure us necessary data from the files of the holding company" (R. 1743, 1744)

Mr. Coulson did not advise the petitioner that it had no financial stake in the consolidated returns, nor did he advise it of his purpose in taking Mr. Curry on this retainer. Respondent approved Mr. Curry's retainer.

On June 1, 1945, Mr. Curry, together with petitioner's files, were moved to Mr. Coulson's office. There he remained until September 10, 1948, when, after the statute of limitations had run against any tax deficiency claim (see p. 26, infra), Mr. Coulson requested him to vacate (R. 656). For 3½ years while in Mr. Coulson's office, Mr. Curry received $3000 per year from Mr. Coulson's firm, for which it was reimbursed by respondent (R. 1749). The only services which Mr. Curry performed for his retainer was to sign the 1944 tax return and execute, as petitioner's president, a power of attorney in its name in favor of Polk (R. 657-8).

The 1944 return was filed June 15, 1945. It was prepared in Mr. Polk's office and brought to Mr. Curry, who occupied

a room a few feet away (R. 1442), to sign (R. 1418). When Mr. Curry first moved to Coulson's office, he was told by Mr. Coulson that he was "to put himself at Mr. Polk's disposal in connection with the consolidated return" (Coulson, R. 1498). When told that Mr. Polk wanted him to sign the 1944 return, he signed, again without consultation with his board of directors and without being advised that petitioner need not file a consolidated return (R. 666).

The Power of Attorney and the Settlement with the Government.

The extent to which petitioner was disregarded and its tax affairs were taken over by respondent is shown by the way the tax settlement with the government was carried out. All negotiations for settlement were conducted by Mr. Polk in petitioner's name but without its knowledge (Polk, R. 1451).

On May 31, 1946, Mr. Polk wrote to the Internal Revenue Agent in Charge, justifying the use of petitioner's loss (R. 1779) but never, at any time, did he advise the petitioner or Mr. Curry of that letter (Polk, R. 1443; Curry, R. 667).

Since the government recognizes only the parent corporation in consolidated returns, it then became necessary for Mr. Polk to obtain a power of attorney from petitioner to continue settlement negotiations. On June 26, 1946, he prepared such a power of attorney running to himself (R. 1784) and sent it to Mr. Curry to sign. Mr. Curry signed because he was told that Mr. Polk wanted it (Curry, R. 668) and he did so without consulting his board of directors. Thereafter, Mr. Polk "conducted all the negotiations in the name of the plaintiff Corporation under [this] power of attorney" (Polk, R. 1441, 1451).

On February 11, 1947, Mr. Polk made to the Commissioner of Internal Revenue the offer of settlement that was accepted by the government in August 1947 (R. 1662). It was made and signed in petitioner's name by Mr. Polk; yet he showed no copy to petitioner or to Mr. Curry, sent no copy to them, and did not even advise them what was going on until April 1947, although during that period Mr. Curry was occupying a room in the Coulson suite (Polk, R. 1442; Curry, R. 654), and despite the fact that this suit had been filed the previous October and was then pending.

While ignoring petitioner, Messrs. Polk and Coulson were meticulous in obtaining authority from respondent to make the offer of settlement in the name of petitioner. Mr. Polk, in Washington negotiating with the Treasury, telephoned Mr. Coulson in San Francisco to secure respondent's authority to make the offer. Mr. Coulson and Mr. Elsey, respondent's president, agreed that this would require authorization by respondent's directors (R. 1283, 1284). It was only after respondent's directors had been polled and approved the offer that Polk delivered it (Coulson, R. 1493-4; Polk, R. 1430). This may be contrasted with his action in writing and delivering the offer in petitioner's name and under its power of attorney, not only without consulting it, but without informing it until two months later.

The reason assigned by Mr. Polk on the witness stand for ignoring petitioner was that he supposed "my responsibility was to them [respondent] and not the Corporation [petitioner]" (R. 1431), although the offer was made in the name of the petitioner and not the respondent. However, "I knew of the pending litigation," and finally it dawned

upon him that his conception of his duty was peculiar, and "I came to the conclusion that they should be notified" (R. 1431). Mr. Polk was in San Francisco conferring about this case with the respondent's attorneys when this revelation came upon him; he telephoned to his New York office to send out a letter over his signature to Mr. Curry as president of petitioner and this was done on April 2, 1947 (R. 1461, 1787).

Therein he requested petitioner's approval of the offer of settlement. Mr. Curry referred it to petitioner's board of directors. Not until then did the board know that Mr. Curry had signed a power of attorney (R. 1023). The board caused a reply to be sent to Mr. Polk on May 5, 1947 (R. 1794). It did not grant approval of the settlement. Commenting on

> "the action of the Western Pacific Railroad Company in opposing judicial settlement of the allocations of tax benefits, if any, derived from the application of the capital losses of the Corporation for the benefit of the Group," it said: "Had there been any question of the Railroad Corporation's right to a determination of the question of allocations of tax benefits, we feel sure that counsel representing both the Railroad Company and the Railroad Corporation would have specifically stipulated, at the time of the filing of the consolidated returns, for such allocation to be determined by the court, if the parties found themselves unable to agree thereto. Inasmuch as in the proposed settlement the Railroad Corporation foregoes its refund claim of $4,200,000, we think it appropriate that a stipulation promptly be entered into between the Railroad Company and the Railroad Corporation, and the other members of the Group, which will insure the Corporation its day in court for a settlement of the questions of proper and

equitable allocations of tax savings, if any, as well as fixing the amount of the refund as the basis for such savings. * * *"

In the meanwhile, on May 6th, Mr. Polk again wrote to petitioner requesting approval of the offer of settlement (R. 1797). But on that very day, without awaiting a reply and knowing that petitioner's request of May 5th had not been met, Mr. Polk renewed the offer of settlement, in petitioner's name, in a conference with Treasury officials, and confirmed that renewal by letter of May 19, 1947 (R. 1799). He signed that letter in petitioner's name and in it he asserted that "The taxpayer [i.e., petitioner] on behalf of itself and its affiliated subsidiaries agrees to settle and determine the tax liabilities of said corporation for the taxable years 1942, 1943 and 1944 in the amount shown on the returns as filed," although the petitioner had not yet given him the authority requested in his letter of May 6th. Mr. Polk never informed petitioner of this letter (Polk, R. 1443), and Curry never heard of it until the trial (R. 681).

Polk's offer of settlement to the Treasury was that the tax returns be accepted as filed, the 1943 and 1944 returns showing no tax, and the claim for refund of the 1942 tax be rejected (R. 171). This offer was accepted by the Treasury on August 13, 1947 (R. 174) and the claim for refund was formally rejected on August 26, 1947 (R. 175).

This settlement could have been repudiated by either party (*Botany Worsted Mills v. United States*, 278 U.S. 282), but was not, and the tax saving became certain and final for the first time on June 30, 1948, when the statute of limitations ran against any deficiency assessment (R. 1751).

Coulson and Polk Never Advised Petitioner of Its Rights.

At no time did Mr. Coulson or Mr. Polk give any advice to any officer of petitioner as to what its rights might be against any other member of the group arising out of the filing of consolidated returns or the use of petitioner's stock loss, or advise petitioner that it was free not to file consolidated returns, although they knew that to be true (Polk, R. 1451-1458).

Petitioner Learns of the Use of Its Stock Loss and Files This Suit in 1946.

In June 1946, a stockholder's bill was filed in New York by certain of petitioner's stockholders (the petitioners in No. 160), charging that petitioner's directors had violated their duty in various respects, including a failure to prosecute petitioner's claim against respondent for its use of petitioner's stock loss in consolidated returns to the advantage of respondent. It was from that suit that petitioner's directors first learned of the use of its loss (R. 1024). Thereupon petitioner's directors caused this suit to be filed in October 1946 (R. 5, 11)

Supplemental Complaint Filed December 1947.

In December 1947, petitioner filed its supplemental complaint, in which it alleged that respondent through its officers and attorneys had controlled petitioner and that by virtue of that control petitioner was caused to file the consolidated returns for the benefit of respondent (R. 208, 231).

3. FINDINGS.

The trial court found the facts in accordance with petitioner's contention. Thus it found:

"On December 17, 1947, plaintiff filed a supplementary bill of complaint * * *. It was there further alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control'." (R. 264)

And:

"* * * there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control.'" (R. 272)

Again:

"* * * in 1943, after the filing of the 1942 return and payment of the tax, *the tax attorneys for defendant* 'discovered' Section 123 of the Revenue Act of 1942. (26 USC 23(g)(4).) *They* proposed what they denoted a 'paradoxical' theory, by which the worthlessness of the plaintiff's stock (which had cost the plaintiff some $75,000,000) in the operating railroad company (debtor), might be availed of as an offset to the operating income of the debtor and thus result in a net loss and no tax obligation." (R. 261, 262)

And again:

"* * * the *tax attorneys caused the filing of* consolidated tax returns for 1943 and for the forepart of 1944 *in the name of plaintiff*, in which sufficient portions of the $75,000,000 stock loss were used as offsets against the operating accounts for these years, so as to show no net income." (R. 262)

"* * * *the tax attorneys for the defendant* conceived a 'paradoxical' plan. *They decided* that *they would* file

* * * consolidated returns on behalf of the parent company and its subsidiaries and in them set up the plaintiff's stock loss * * * as an income tax deduction against the operating profits." (R. 265, 266)

And:

"The returns * * * were prepared by the employees of the debtor [respondent] and signed by the president of the plaintiff corporation, although they were never submitted to its board of directors for approval or consideration" (R. 261)

Also:

"a claim for refund * * * was filed *in the name of* the plaintiff" (R. 262)

"The validity of the offsets was questioned by the Commissioner of Internal Revenue and conferences were had *between the tax counsel for the defendant* and the Commissioner. As a result, a tax settlement was made with the Commissioner whereby, in consideration of the withdrawal of the claim for refund, the Commissioner accepted and approved the returns" (R. 262, 263).

In short, the trial court found that respondent filed the returns and effected the settlement with the government, making use of petitioner's name, and that petitioner was not the actor. This is further shown by the proceedings on the settlement of the findings.

In its opinion the trial court admonished that it would only receive proposed findings pertinent to its theories (R. 276); petitioner was thus precluded from requesting findings on "duality" and "domination" as such (see p. 36, infra), but the same facts bore on the issue whether peti-

tioner took part in the tax transactions so as to be party to the wrongdoing which the trial court believed had been worked on the government. The matter was therefore raised.

On the settlement of the findings, the trial court said that it agreed with the petitioner's proposed finding on the subject. Noting that the court's opinion "decided the case on the basis that the taxes ought to have been paid the government" which sounded "on the principle that the court will not interfere between wrongdoers, or possibly like the doctrine of unclean hands," petitioner's counsel said that his proposed findings "in essence * * * go to the fact * * * *that the plaintiff did not itself conduct the tax transaction*" (R. 462, 463). And this colloquy occurred:

> "* * * the evidence certainly discloses that the tax operations, however they may be characterized, were conducted by the defendant and its tax counsel, not by the plaintiff.
>
> "The Court: *There is no question about that.*" (R. 468)
>
> * * * * * * *
>
> "The Court: Why couldn't one finding be sufficient to cover that, then: that the court finds that in the preparation of the documents, in the conferences and in all matters having to do with the settlement arranged with the Bureau of Internal Revenue, *the plaintiff did not participate?* Couldn't you simplify that by making one finding?
>
> * * * * * * *
>
> "Mr. Lasky: Your Honor's opinion of course also referred to the signing of various papers by the plaintiff's president. Of course Mr. Curry was the plaintiff's president, and our point here was that while he signed them, that really was not the plaintiff's act.

"The Court: *Didn't I say too the Board of Directors were not—*

"Mr. Lasky: I think you may have said it with respect to some matters but not others. I don't think it was said with respect to the power of attorney." (R. 470).

The court then said "that most everything you have mentioned is really in the opinion some place or another" (R. 476) and finally entered an order adopting its opinion as its findings (R. 319).

C. Other Relevant Facts.

STIPULATION OF AUGUST 1947 AND PRE-TRIAL ORDER.

Settlement with the government in August 1947 had not yet been effected when this suit was commenced in October 1946.

Petitioner was concerned that the form of the settlement should not prejudice its rights. Under the law and regulations, any refund of 1942 taxes would be paid to it (Reg. 104, Sec. 23.16(a)). But the form of the proposed settlement called for rejection of the claim for refund and would thus leave respondent in possession of all the tax savings. Petitioner therefore negotiated with respondent for a stipulation to protect it. Before it was executed, intervening stockholders (petitioners in No. 160), being fearful that the stipulation did not adequately protect petitioner's rights, applied to the District Court for relief. After hearing (R. 335-339) that Court made a pre-trial order construing the stipulation (R. 163), upon the basis of which the parties executed it on September 3, 1947 (R. 168-175).

The effect of the pre-trial order was to distribute the tax savings of $17 million over the three-year period, attrib-

uting $3,385,290 to 1942. The claim for refund was not to be deemed to have been abandoned but to be diminished in proportion to the diminution of the entire tax savings, and placed in the same status as if it had actually been refunded and paid by the government to the petitioner and by it paid into court to await judgment.

CONSUMMATION OF THE REORGANIZATION.

The reorganization plan provided that it could be carried out either by revesting the properties (then in the trustees' hands) in the debtor, or by transferring them to a new corporation formed for the purpose (233 I.C.C. 453). The Reorganization Committee concluded that it would be advantageous to have the properties revested in respondent (the debtor) (R. 621). But to permit this, it would be necessary to secure the surrender by petitioner of its stock in respondent.

Accordingly, on November 22, 1943, the Reorganization Committee made a contract with petitioner and certain of its creditors, whereby petitioner agreed to surrender its shares to the Committee or its nominee for this purpose. On December 17, 1943, the bankruptcy court approved the "use of the debtor company" in carrying out the plan (R. 1930), and on April 30, 1944, the stock was surrendered by petitioner to the Reorganization Committee (Chart P 1).

Thus the affiliation for income tax purposes between petitioner and respondent did not cease until April 30, 1944. But the economic interest of petitioner in respondent had ceased for all time in 1943 when this Court affirmed the I.C.C. decision denying petitioner any participation in the reorganization and declaring its stock holding to be worth-

less. All control of respondent by petitioner had forever ceased when the bankruptcy trustees were appointed in 1935.

The reorganization plan was confirmed in October 1943 (R. 1674). In November 1944 the bankruptcy court made its revesting order (R. 36). Pursuant to that order and on December 29, 1944, the properties were turned back to respondent by Trustees' deed and, under date of December 14, 1944, respondent executed an Assumption Agreement assuming, among other liabilities, "any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use, or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business * * *" (R. 1711, 1713). Pursuant to the plan respondent also assumed all taxes due the United States from the debtor or the debtor's trustees for any period prior to January 1, 1945 (R. 36 at 49).

The tax returns for 1943 and 1944 and the claim for refund for 1942 were all filed after the economic unity of the group had ceased and also after tax affiliation had ended. The filing of the 1942 refund claim and the 1944 returns also occurred after respondent was out of the hands of the Trustees.

RESPONDENT IS THE SAME CORPORATE ENTITY THAT WENT INTO BANKRUPTCY, BUT ITS FORMER STOCKHOLDERS WERE COMPLETELY WIPED OUT.

Respondent has sought to distinguish between the "pre-reorganization The Western Pacific Railroad Company," the "reorganized The Western Pacific Railroad Company" and the trustees during reorganization.

But respondent is the same legal entity in which petitioner made its original investment of $75 million. It is and was the same legal entity throughout, before, during, and after bankruptcy. The actual railroad operations continued without interruption during the bankruptcy in the name and under the direction of respondent's officers.[18] And, as just noted, the assets were revested in the same corporate entity at the end of 1944.

But respondent is now a complete financial stranger to petitioner and has been since March 15, 1943, albeit "paradoxically" affiliated for income tax purposes until April 30, 1944. From the moment respondent went into bankruptcy in 1935 and its properties passed into the control of the bankruptcy trustees (R. 1916), petitioner lost all control over it, and never regained it. During all the time involved in the tax returns, petitioner and respondent were complete economic strangers, and petitioner had no control whatever over respondent.

As the Court of Appeals correctly stated, after 1935 respondent "was no longer controlled by Corporation [petitioner] but by the trustees appointed by the bankruptcy court" (R. 2223), and after adoption of the plan of reorganization "affiliation no longer existed" (R. 2231).

When it emerged from reorganization on December 29, 1944, the respondent had entirely new owners. Petitioner's investment of $75 million had been wiped out as well as its advances amounting to $7,750,000. No other interest was exterminated except that of a subsidiary of petitioner

[18] The court order provided that the "business shall be conducted in the name of the debtor by its regularly elected or appointed corporate officers, agents and employees, but under and subject to the direction of said trustees" (R. 1921).

amounting to $61,667. Other interests were given income or equity securities in place of fixed debt, or scaled down, but these securities were greatly enhanced in value by the operations during bankruptcy when $30 million of revenue was devoted to additions and betterments and $6 million to rolling stock (1944 Annual Report, P-20C, p. 9; reprinting in the record of the annual reports was dispensed with by order).

THE $10,100,000 RESERVE FUND TO PAY THE TAXES.

Throughout 1943 respondent made accruals in excess of $7 million to meet the expected 1943 tax liability, and for the first four months of 1944 it made accruals in an amount exceeding $3 million (R. 614, 1818-1824).

When Polk advised respondent in December 1943 that petitioner's loss could and should be used in the 1943 returns, he recommended that respondent's accruals for 1943 taxes be placed in a special reserve until the taxes were finally determined (R. 601-3). By order of the bankruptcy court on March 3, 1944, $7,100,000 was designated "Reserve Fund for Contingent Tax Liabilities" and invested in U. S. Treasury securities to be used to pay any federal taxes found to be due for 1943 (R. 616).

In March 1945, three months after it was out of the hands of the Trustees, respondent established a further reserve of $3 million against federal taxes, which was also invested in government securities (R. 616).

These reserves, aggregating $10,100,000, were still intact in respondent's hands at the time of the trial (R. 616). Since the tax settlement with the government, respondent has carried them as a contingent reserve to meet any judgment in the present action (R. 517, 518).

D. Summary Recapitulation of Basic and Incontrovertible Facts.

1. Petitioner sustained a loss of $75 million when its stock in respondent became worthless.

2. It ceased to have any economic interest in respondent on March 15, 1943.

3. Respondent thereafter used petitioner's loss to discharge respondent's tax liability of $17 million.

4. Respondent conceived the plan of using petitioner's loss and carried it into execution by directing the action of petitioner's president, who was also an officer of respondent and in its exclusive pay.

5. Respondent's tax saving resulted from the conjunction of two elements. First, it had to obtain petitioner's joinder in consolidated returns. In addition, it had to use the loss. The loss was petitioner's loss.

E. Decisions of the Two Courts Below.

The trial court found the facts in favor of petitioner but rendered judgment for respondent. The basis of its decision was its belief that it was "puzzling, if not downright amazing" that respondent could avail itself of petitioner's loss (R. 267); that respondent's tax "escape" was "erroneous and unjust" (R. 271), and that if the court "had the power, I would not hesitate to set aside the tax settlement" and "order these taxes paid to the United States" (R. 270). In short, its theory was the view that the tax savings ought not to have been allowed by the Treasury, that a wrongdoing or species of fraud had been worked on the government.

The trial court's second but minor ground was that petitioner was somehow seeking to go behind the reorganiza-

tion proceedings, which had denied petitioner any interest in respondent's properties.

Not the least of the peculiar consequences of the trial court's conclusion was that it left the proceeds with the party whom the court found to be the wrongdoer. The dissenting opinion of Judge Fee in the Court of Appeals clearly stated the situation (R. 2239-41):

> "The Trial Court gives two reasons for decision against plaintiff: * * * Neither has any validity.
>
> "The major portion of the opinion of the Trial Court is devoted to the proposition that the 'tax escape' was a fraud upon the government, and therefore the proceeds were given to the defendant, an active wrongdoer. * * * The majority of this Court, as the opinion shows, does not rely upon it.
>
> "A second subsidiary theory was also advanced below with little emphasis. * * * This reason is as unstable as the first."

The Court of Appeals swept aside the trial court's legal theories as erroneous. It stated of the major theory, "We do not share this view" (R. 2227-2228, fn. 12). Nevertheless, by a 2 to 1 decision, it decided against petitioner and affirmed the judgment on a legal theory all its own.

Its basic reasoning is as follows: If respondent controlled petitioner, it had a fiduciary obligation to deal with it fairly (R. 2223). But it did not violate this duty in filing the consolidated returns or in the failure of the common officers to request and obtain an agreement for compensation for use of petitioner's tax rights, or in respondent's failure to give petitioner an opportunity to appoint independent officers who could have made such an agreement.

These acts were not unfair, said the court, because petitioner was under a duty to file such returns; it could not have demanded an agreement of compensation for doing so, all because petitioner was bound to give to respondent the benefit of its loss (R. 2232-2234).

The opinion sums up: "Equity will not permit a recovery as a substitute for a bargain which would have been unfair," i.e., no bargain for any compensation would have been fair (R. 2235). In short, it was petitioner's duty to give up its sole asset to respondent for nothing.

The majority opinion thus announced a new principle of law, viz.:

That wherever the tax laws permit two corporations to join in consolidated federal tax returns, and one has a loss and the other has income, the former must join with the latter and permit its loss to be used for the latter's benefit, without payment, consideration or compensation.

And since respondent was no longer a subsidiary of petitioner,[19] the principle as applied went further, namely:

A former parent is under a duty to join in a consolidated return and permit its loss to be used to satisfy the former subsidiary's tax, without consideration or compensation, even though it has no economic interest in the latter and can derive no benefit therefrom.

This was tantamount to holding that the income corporation can sue in equity for a mandatory injunction to compel the loss corporation to join and confer the benefit of its loss, gratis.

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[19] As the opinion itself states, "when the returns and the claim for refund were filed, affiliation no longer existed" (R. 2230-1).

SPECIFICATIONS OF ERROR

The United States Court of Appeals for the Ninth Circuit erred:

1. In holding that wherever the federal tax laws permit two corporations to join in consolidated federal income and excess profits tax returns, and one has a loss and the other has income, the former must join with the latter and permit its loss to be used for the latter's benefit, without consideration or compensation.

2. In holding that a former parent corporation is under a duty to join in consolidated income and excess profits tax returns and to permit its losses to be used to satisfy the former subsidiary's tax liabilities, without consideration or compensation, even though it has no economic interest in the latter and can derive no benefit therefrom, and particularly, that it must do so to permit the former subsidiary to utilize the very loss sustained by the former parent by reason of losing its stock interest in the former subsidiary.

3. In holding that after a parent corporation has had its equity in another corporation wiped out by reorganization in bankruptcy and has thus been left with a huge loss, the former bankrupt may then use the loss for its own financial advantage.

4. In holding to be irrelevant the facts that respondent dominated and controlled petitioner, that petitioner's officers were employees and officers of the respondent deriving their livelihood from it, and that by reason of such domination and control respondent was a fiduciary to petitioner and was enabled to and did appropriate, seize and use petitioner's tax rights for respondent's own enrichment without petitioner's consent.

5. In affirming the judgment of the District Court which denied any relief to petitioner, and in failing to hold that petitioner is entitled to an accounting from respondent and to a decree directing payment of an equitable portion of the respondent's tax savings for the years 1942, 1943 and the first four months of 1944, amounting to $17,201,739.

6. In failing to direct entry of judgment that petitioner have and recover from respondent the full amount of said tax savings.

7. By exceeding its appellate office in making findings of fact *ab initio* to affirm the judgment of the District Court upon a legal theory different from that on which the District Court acted, the theory of the Court of Appeals being unsupported by and inconsistent with the facts found by the District court.

8. In holding that a litigant (here petitioner) has no right to petition for a rehearing in banc or to have such petition considered and acted upon by all the members of the court, and in holding that a Court of Appeals has no power to grant such a rehearing after decision by a panel in the absence of approval of a majority of the panel.

SUMMARY OF THE ARGUMENT

I. Respondent has been enriched by $17 million by appropriating petitioner's tax rights to extinguish its own federal tax liabilities.

Assertions that a judgment for petitioner will in effect give it an interest in respondent denied by the reorganization plan, and thus circumvent the plan, and that it will give petitioner an interest in respondent's earnings accrued while in the bankruptcy trustees' possession, are fallacious.

Petitioner's claim does not circumvent the plan because the plan contemplated and required that respondent pay its taxes and did not contemplate that it would appropriate a stranger's (petitioner's) property to satisfy them. A judgment for petitioner will not take earnings respondent is entitled to keep but moneys which it would have paid into the Treasury if it had not appropriated and used petitioner's loss; respondent will be deprived of nothing it would possess if it had filed its own separate income tax returns and paid its taxes.

The benefit to respondent from taking and using petitioner's loss to discharge its taxes, and the applicable legal principles, are exactly the same as if respondent had taken currency from petitioner and used it for the same purpose. What petitioner prays is compensation for property belonging to it which respondent took after the plan of reorganization was consummated and which did not even exist until after that consummation. The consummation of the plan created the factual situation which made the later tax savings possible. Drastic as it was, and because it was drastic, the plan left petitioner with a $75 million loss possessing value for tax utilization. Having impoverished petitioner by taking ownership of respondent as the plan contemplated, respondent's new owners have gone beyond the plan, by taking from petitioner, an economic stranger, all it had left in order to enrich themselves further.

The plan was promulgated by the I.C.C. in 1939 before the tax savings were even conceived. Indeed the statute which made them possible was not enacted until October 1942. Both the plan and the revesting order required respondent to pay its federal taxes; it expressly assumed the

obligation; and it emerged from the reorganization with more than ample funds to do so, in a financial state vastly better than the plan envisaged, and with cash reserves set aside for the purpose. But thereafter it discharged its obligation by seizing and using what belonged to petitioner.

II. Petitioner is entitled to recover under principles of unjust enrichment, which require restitution. A person is enriched where he has received a benefit from use of what belongs to another. Saving one from loss or expense confers a benefit. Tax savings constitute enrichment subject to the principles of unjust enrichment. An enrichment is unjust if retention by the enriched party of the benefit would be unjust. Respondent's retention is unjust for two major reasons.

III. The first major reason is that retention would be inconsistent with the rationale of consolidated returns and the purpose of Congress in allowing them.

The rationale is that a group of affiliated corporations is an economic entity and, unless the group as a whole shows a profit, those who conduct the business, the parent's owners, have realized no gain. For this reason the common owner's right to set off the gains in one corporation against the losses in another is recognized, with the purpose and effect to benefit the ultimate owners of the business entity, i.e., the parent's stockholders. The object is to ameliorate the losses.

Two principles are evident: The tax savings should go (a) to the ultimate owner of the economic entity, the parent, and (b) to the party suffering the loss to ameliorate it. These two principles coincide here because the loss used to produce the tax savings was the former parent's loss. The

two principles also coincide wherever the economic unity continues. Where the unity has been severed so that the benefit of the tax remission granted by Congress cannot reach the parent through its stock ownership, the parent should be allowed to recover directly in order that the remission may be applied against the loss.

Consolidated reporting has been justified by Congress and the courts on the ground that "no ultimate advantage under the tax laws really results" and that "no improper benefits are obtained from the privilege," for Congress did not intend the privilege [to] be enjoyed solely for "tax reducing purposes." If the former subsidiary, after severance of the economic unity—the very event producing the parent's loss, is permitted to retain the tax savings without making restitution to the parent to ameliorate its loss, both equities underlying the principles of consolidated income tax reporting are defeated, an ultimate advantage under the tax laws has resulted, improper benefits have been obtained, and only a tax reducing purpose has been served: New owners of the former subsidiary will reap a sheer windfall from the misfortune of the old and the income tax laws will be subverted into a tool to enrich strangers.

IV. The second major reason why retention of the enrichment would be unjust is that respondent was able to appropriate petitioner's loss and right of use because it dominated petitioner and occupied a fiduciary relation to it.

One is entitled to recover for a benefit conferred unless he intended to make a gift. There was no gift here; respondent simply took petitioner's asset. Petitioner's directors lacked power to make a gift, duality of representation pre-

cluded any corporate intent to make one, and petitioner's directors knew nothing of the use of its loss.

After this Court's decision of March 15, 1943, everyone having to do with petitioner's affairs was under the highest obligation to see that such rights as were left to it and to its stockholders were not dissipated, violated or neglected, and those representing it and respondent, in dual capacity, were under the rigid duty not to permit petitioner's rights to be used for the benefit of respondent without an accounting. Desiring to use petitioner's tax rights, respondent should have openly disclosed to petitioner the utility of those rights and the legal and economic consequences of their use and should have requested petitioner's consent and given it the opportunity to obtain independent representation to permit a consensual arrangement. Respondent did not do so but sought to deprive petitioner of the opportunity to protect for itself the value of its corporate asset.

Respondent was a fiduciary to petitioner because it took over the conduct of petitioner's tax affairs and assumed to deal with petitioner's properties and rights in a manner designed to benefit itself; to this end it used petitioner's officers who were respondent's employees paid by it; and it took it upon itself to act as petitioner's agent and while so acting used petitioner's rights. By reason of petitioner's moribund condition and its loss of control over respondent, coupled with the latter's reinvigorated condition and the fact that petitioner's officers and most of its directors were mere employees of respondent from which they received their livelihood, the former subsidiary was the fiduciary to the former principal, for what makes one corporation a fiduciary of another are the elements of domination and the existence of control and management.

A fiduciary may not avail himself of any advantage or facility that the position gives him. He must account to the beneficiary for the full benefit derived from the use of any property or rights of the beneficiary, from the fact of the relationship or from the opportunities or facilities it affords.

V. The arguments advanced against recovery are without merit.

1. The basic holding of the Court of Appeals is that petitioner was under the duty to join in consolidated returns and to confer upon respondent, gratis, the benefit of its tax credit. No such duty can be found in the tax laws or regulations, which make clear that the parent is free to make its own decision about filing consolidated returns on the basis of its own interest. This is particularly true where the economic unity has been severed.

The court below by judicial fiat has made mandatory what Congress left optional. No duty of petitioner to give its tax rights away can be derived from any principle of equity. Creditors of a reorganized company, after supplanting the former shareholders, have no right to appropriate still other property of the former shareholders.

2. Underlying the basic decision below is the further holding that respondent had a right to expropriate petitioner's loss because petitioner was so unfortunate as to be left destitute, with no taxable income, and could therefore not itself achieve tax advantages by use of its loss, while respondent had use for it. But petitioner's rights to recover rest on benefits conferred and are not confined to detriment sustained. Property, assets or rights cannot be taken from one without compensation merely because he cannot use them profitably himself. Their protection from seizure or

trespass does not depend upon what use or benefit the owner can make of them. The contrary rule reflects itself in every field of law, in suits for the use of land, in unjust enrichment cases where recovery is measured by benefits conferred, not detriment sustained, in every case of a fiduciary's profiting from the relationship where he must account for the profit though the beneficiary suffered no loss and could not have made the gain, in patent and condemnation cases, and in a variety of other situations.

The utility of the loss to respondent itself gave and measured the value to petitioner.

3. Respondent asserts that a loss is "negative", may therefore not be called "property" or an asset or placed in any traditional category of common law liability: therefore it cannot furnish the basis of a right and a remedy. Terminology, such as "property," is not the source of rights; the reverse is true. The loss had a positive value, because it had a valuable use and was actually used by respondent to save $17 million. The tax savings did not spring automatically from the tax law; the law merely permitted the savings provided respondent could introduce itself into consolidated returns with petitioner and offset its loss against respondent's income.

4. The decision below was based in large part on the so-called practice of the parties in filing consolidated returns in earlier years. But alleged past practice is irrelevant. (1) It ignores the severance of the economic unity; it ignores the fact that while petitioner was respondent's owner before this Court's approval of the reorganization plan in March 1943, thereafter the parties became total strangers to each other and respondent was no longer in any real sense the same

party that had filed consolidated returns with petitioner in prior years but a total economic stranger. (2) Prior to October 1942 the tax laws did not permit the use here made of a loss like this and therefore there was no prior practice on the use of such loss. (3) There was no past practice about giving away a sole asset. (4) The evidence does not support the alleged past practice. And (5) past practice can be relevant only to the construction of a contract, but here there was no contract, and what was done prior to the severance of the economic unity is no evidence of a contractual consent to what was done thereafter in circumstances utterly different. The District Court considered the alleged past practice to be irrelevant.

5. Petitioner's rights do not depend on whether a prior agreement between it and respondent would have been possible. But such an agreement would have been perfectly legal.

6. There is no merit to the trial court's theory that petitioner should be denied recovery because respondent defrauded the government. The tax savings, having resulted from a final settlement with the Treasury, must be accepted as a starting point in the case. And if a wrong was perpetrated, respondent was the wrongdoer and should not have been rewarded by being allowed to retain the enrichment. A fiduciary cannot refuse to account for gains arising from his own wrongdoing.

7. Respondent asserted in its brief in opposition to certiorari that petitioner's claims, even if valid, were cut off by failure to present them to the bankruptcy court. But petitioner's claims arose after the revesting of the railroad properties in respondent in December 1944. Not only

were the claim for refund of 1942 taxes and the 1944 tax returns filed thereafter, but none of the tax savings arose until settlement was made with the Treasury in 1947, and they resulted only from the acts of the respondent, after bankruptcy was over, in adopting the returns and, in petitioner's name, prevailing upon the tax authorities to accept them.

Furthermore, respondent in writing assumed all obligations and liabilities incurred by the trustees and so assumed the liability to petitioner if it had theretofore arisen. The assumption was required by order of the bankruptcy court made pursuant to the settled practice and principle that the purpose of bankruptcy proceedings is to discharge or readjust debts existing at their inception and not to destroy claims arising from acts of the court's officers during the proceedings.

VI. The Court of Appeals said that it would deny recovery even though respondent did dominate and control petitioner, although concurrently it denied the fact of such domination and control. This denial was but a conclusion based on the irrelevant alleged past practice of filing consolidated returns. The trial court found the fact of domination and control and resulting appropriation, both formally and informally, and made clear that it would have formally made further findings except that the issue was immaterial to the legal theories on which it decided the case.

The record not only supports but requires this finding by the trial court of domination and control. If there were any basis for a conclusion that the trial court had not found the fact and that a contrary finding is possible, the cause would have to be remanded to the District Court for find-

ings. A Court of Appeals may not affirm a judgment on a legal theory different from that on which the trial court acted, when the new theory is based upon a fact not found or contrary to one found by the trial court. The Court of Appeals exceeds its appellate office by making findings *ab initio.*

VII. The Court of Appeals erred in denying petitioner the right to petition for a rehearing in banc.

VIII. Since the undisputed facts and the trial court's findings of fact require judgment for petitioner, further proceedings following reversal are unnecessary, and the cause should be remanded with directions to enter judgment for petitioner. The amount of recovery should be the tax savings, because (1) this will ameliorate petitioner's loss, thus serving the purpose of consolidated tax reporting, while retention of any part by respondent would be a sheer windfall, and (2) the principles respecting abuse of the fiduciary relationship so require. By failure of complete disclosure and by unilateral seizure of petitioner's rights, respondent denied petitioner the right to determine for itself the value of its asset. The "price of denial" is that respondent must now account.

ARGUMENT

I.

The Relief Sought by Petitioner Does Not Circumvent Respondent's Bankruptcy Reorganization or Permit Petitioner to Share in the Equity Which the Reorganization Plan Denied It.

From the outset respondent has urged that petitioner is here endeavoring to circumvent the reorganization plan by

seeking to share in the equity which the reorganization plan denied it.[20]

This argument ignores completely the basis of petitioner's claims. Petitioner seeks to compel respondent to account for the unjust enrichment resulting from respondent's appropriating and using petitioner's tax rights to satisfy respondent's federal tax liability. Judge Fee, dissenting in the Court of Appeals, commented (R. 2251): "The error of the lower court was in assuming that plaintiff is seeking an interest in defendant corporation instead of compensation for property taken by defendant which belonged to plaintiff."

If the subject matter of this suit were a bag of gold coin belonging to petitioner which was appropriated by respondent to pay its taxes, no court would hesitate to hold it accountable to petitioner. That the subject matter is a $75 million loss sustained by petitioner, which respondent used to discharge its tax liability, may present a unique factual situation but it does not involve unusual legal principles.

Petitioner's claim is not remotely in derogation of the reorganization plan. In asking that the benefit of the tax savings be adjudged to belong to it, petitioner does not remotely seek to undo the plan, but accepts its consequences in full. The consummation of that plan was not the end, but only the threshold, of this case.

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[20]The District Court said that the suit was "a circuitous way of obtaining something in the nature of equity or value for its ownership, rejected in the reorganization plan" (R. 272), and that "to make any award in this cause, under the assumed authority of equity principles, would be in effect to modify the administrative and judicial judgments in the reorganization proceeding" (R. 274).

The tax savings arose *after* the plan was fully consummated. It was the *fulfillment* of the plan—the very fact of its full and complete consummation—that created the factual situation which made the *later* tax savings possible. The plan was drastic. It wiped out the entire stock ownership of the old stockholder. In *Bondholders, Inc. v. Powell*, 342 U.S. 921 (Jan. 28, 1952) and again in *Chemical Bank & Trust Co. v. Group of Institutional Investors*, 343 U.S. 982 (June 9, 1952), Mr. Justice Frankfurter noted that due to erroneous estimates of future earning power, valuable equities were forfeited in a series of railway reorganizations of which the first was respondent's, *Ecker v. Western Pacific Railroad Corporation*, 318 U.S. 448. Although petitioner's stock in respondent was declared worthless in the *Ecker* case, respondent's taxable earned income in 1942, 1943 and the first quarter of 1944 was $32 million.

Nevertheless no complaint is made by petitioner of this deprivation of its stock ownership and no relief against it is sought in the present suit. But the consummation of the plan, having stripped petitioner of that ownership, left it with something in its place—a huge loss and a right to utilize it for tax purposes.

It was then that respondent went beyond the plan and seized what petitioner had left—its loss and right—to increase respondent's surplus by an additional $17 million.

This was no part of the plan. Indeed, the plan could not have commanded petitioner to give its tax rights to the bankrupt, even had it purported to do so (*Callaway v. Benton*, 336 U.S. 132).

The tax savings here involved had no bearing on the type of reorganization. They were unexpected—in the words of respondent's counsel, "fortuitous." The 1942 amendment

to the Revenue Act which for the first time permitted the use of the stock loss to offset ordinary income and thus made possible the saving here was not enacted until long after the plan was promulgated (see p. 8, supra).

The plan contemplated that the reorganized respondent should pay its income taxes. It explicitly stated (233 I.C.C. at 455) that

> "Notwithstanding any other provisions of this modified order, the reorganized company shall assume the liability for, and shall pay in full in due course, any and all taxes due to the United States from the debtor or the debtor's trustees for any taxable period prior to the date of the confirmation of the plan * * *."

The "revesting order" of November 27, 1944, by which the properties were restored to respondent and freed of bankruptcy administration, provided (para. 9) that respondent must

> "assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945 * * *." (R. 36 at 49)

In consideration of the transfer to it by the Trustees of all assets in their hands, respondent executed an "Agreement of Assumption" on December 14, 1944, effective December 29, 1944, in the form authorized by the revesting order (R. 1711). Thereby it specifically agreed to

> "assume the liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945 * * *." (R. 1716)

Respondent thus assumed the liability to pay the federal taxes. And it proceeded to make provision to do so. It paid the taxes for 1942, it made monthly accruals to pay them for 1943 and 1944, and it set aside reserves of $10,100,000 for that purpose. As late as August 1944, the trustees reported to the bankruptcy court that, after the deduction of the $7,100,000 reserve fund for 1943 taxes, the 1943 earnings were so large as to leave $8,929,844 available for dividends on the common stock, in addition to more than $11,500,000 required to carry out the provisions of the plan (R. 1195, 2179, 2188).

Like its competitors, the Southern Pacific and the Santa Fe, respondent was expected to pay its taxes on its war-swollen profits. This tax liability, which it was bound by the plan to pay and for which it had made cash provision, it discharged—not with the cash which it had set aside, and which it still had available for the purpose and which it yet has, but by the subsequent appropriation and use of petitioner's tax credits, which the Treasury accepted in August 1947.

Petitioner's rights are based on principles of law which became operative by reason of that *subsequent* appropriation and use.

Here the plan of reorganization had been prepared, approved and affirmed by this Court before the notion of saving taxes by use of petitioner's loss was even conceived. Even after its subsequent conception in 1943, it remained a "mere speculation of a possibility" until respondent first decided, in January 1944, to make use of the loss. In the meanwhile the plan was approved by the creditors and confirmed by the bankruptcy court, and thus had al-

ready become effective to fix the rights and legitimate expectations of respondent, its creditors and security holders.

The plan did not contemplate that the reorganized respondent would emerge from bankruptcy with any surplus at all. But it emerged with an unappropriated earned surplus of nearly $30 million.[21] The capital structure fixed by the plan was devised by the Interstate Commerce Commission so that the reorganized Company would be able to pay a dividend of $3.00 per share per annum out of the income it could reasonably expect to earn. But in 1943 the company earned $27.99 per share of common stock, after setting aside the $7,100,000 tax reserve, or $50.24 before setting aside the reserve, and in 1942 it earned $20.28 per share (R. 2179 at 2189, 2190, par. 11f and 12).

During the trusteeship $30 millions of operating revenues were used for additions and betterments, and another $6 millions of operating revenues were used to replace old equipment (p. 35, supra). After all this, the remaining income from the effective date of this plan until December 31, 1943 was sufficient to meet all bond interest and to make all payments into the capital fund and sinking fund required by the plan, and still leave $20,658,938 (R. 1196).

Enjoying all the benefits of the drastic features of the plan, respondent, its new stockholders, and those investing in its securities, as well as the court, all expected it to pay its taxes. The statements issued by respondent to the public disclosed the contingent tax liability and the existence of $10,100,000 of reserves in government bonds set aside to meet it. No one supposed—no one would have had a right

[21] 1945 Annual Report, P 20D, page 15.

to suppose—that respondent would escape this liability by appropriating what belonged to another.

A judgment for petitioner will take from respondent nothing that it would have had if it had filed separate income tax returns and paid its taxes in cash. On the other hand, if respondent has judgment, its new owners will not only have taken ownership from petitioner (as the plan contemplated), thereby inflicting a $75 million loss, but they will also have taken from petitioner, now an economic stranger already impoverished for respondent's benefit, tax credits resulting from that loss to enrich their position by an additional $17 million, something never contemplated by the plan.

The trial court argued that petitioner is seeking to share in respondent's earnings and that this Court's affirmance of the reorganization plan denied it that right by divesting it of stock ownership (R. 273).

But suppose that respondent had discharged its tax liabilities with cash taken from petitioner. Or suppose that the rolling stock used by respondent had been owned by petitioner and leased to respondent, and respondent then seized it outright. A plan of reorganization holding, as this plan did, that petitioner's stock ownership was worthless would cut off its right as a stockholder, but it would not transfer to respondent the rolling stock, and it could not if it would (*Callaway v. Benton*, 336 U.S. 132). If, then, respondent took the rolling stock, would it be exonerated from duty to pay for it? It could be said, no doubt, that if respondent repaid the cash taken or paid for the rolling stock, it would do so out of its "earnings." But the statement would be a mere play on words.

The judicial divestiture of petitioner's ownership of respondent does not render the latter immune from the duty, otherwise existing, to account for the value of other rights of petitioner which it seized after the consummation of the plan of reorganization—rights which were not in existence until after the plan was consummated—to the further enrichment of respondent and its new owners.

II.

Petitioner Is Entitled to Recover Under Principles of Unjust Enrichment

Fundamentally, petitioner is entitled to recover on the principles of unjust enrichment. It is in the law of quasi-contract that law and equity continue to maintain that capacity to do justice in new situations for which the Anglo-American system of jurisprudence is deservedly famous.[22]

As stated of this case in 65 Harvard Law Review at 1257, "If, as has been suggested, the Court should not have found that [petitioner] had a duty to file consolidated returns, then principles of restitution for unjust enrichment should have governed the decision."

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[22] 1 Williston on Contracts (Rev. ed.), p. 9, states:

> "* * * quasi-contractual obligations are imposed by the law for the purpose of bringing about justice without reference to the intention of the parties * * *."

and

> "As the law may impose any obligations that justice requires, the only limit in the last analysis to the category of quasi contracts is that the obligation in question more closely resembles those created by contract than those created by tort."

And cf. *Humboldt Sav. Bank v. McCleverty*, 161 Cal. 285, 292, 119 Pac. 82: "It has always been the pride of courts of equity that they will so mould and adjust their decrees as to award substantial justice according to the requirements of the varying complications that may be presented to them for adjudication." And cf. *Addison v. Holly Hill Co.*, 322 U.S. 607 at 620.

A. THE BASIC PRINCIPLE.

The applicable principle is set forth in the *Restatement of Restitution,* Section 1:

> "A person who has been unjustly enriched at the expense of another is required to make restitution to the other."

The meaning of this rule is amplified by the Comment that follows:

> "a. A person is enriched if he has received a benefit (see Comment b). A person is unjustly enriched if the retention of the benefit would be unjust (see Comment c). A person obtains restitution when he is restored to the position he formerly occupied either by the return of something which he formerly had or by the receipt of its equivalent in money. Ordinarily, the measure of restitution is the amount of enrichment received (see Comment d), but as stated in Comment e, if the loss suffered differs from the amount of benefit received, the measure of restitution may be more or less than the loss suffered or more or less than the enrichment."

Comment b states:

> "What constitutes a benefit. A person confers a benefit upon another if he * * * in any way adds to the other's security or advantage. *He confers a benefit not only where he adds to the property of another, but also where he saves the other from expense or loss. The word 'benefit,' therefore, denotes any form of advantage.* The advantage for which a person ordinarily must pay is pecuniary advantage * * *."

It is self-evident that respondent has been enriched. The discharge of its tax liability, by the use of petitioner's loss and credits, was the conferring of a benefit upon respondent

and its enrichment, just as much as if it had taken dollars from the petitioner and with those dollars discharged its tax liability.

B. THE SHREVEPORT BANK CASES:—THE DUTY OF RESTITUTION APPLIES WHERE THE ENRICHMENT CONSISTS OF TAX SAVINGS.

The duty to make restitution applies just as much where the enrichment consists of tax savings as where it consists of some other kind of benefit. As said in 65 Harvard Law Review 1257, "a tax saving may constitute enrichment."

In *Connolly v. Commercial National Bank in Shreveport*, 189 F.2d 608 (5 Cir.), *Commercial Nat. Bank in Shreveport v. Connolly*, 176 F.2d 1004 (5 Cir.), and *Commercial Nat. Bank in Shreveport v. Parsons*, 144 F.2d 231, 145 F.2d 491 (5 Cir.), cer. den. 323 U.S. 796, one corporation was ordered to account to another for tax savings resulting from the use of the latter's tax credits. Numerous other issues were involved in the suit, but on the issue that is relevant here the facts are as follows:

The Commercial National Bank *of* Shreveport [the old bank], being in financial straits, transferred its assets to a new bank, Commercial National Bank *in* Shreveport [the new bank], and the latter assumed its liabilities. Later a receiver for the old bank was appointed and, still later, sued the new bank for an accounting.

The State of Louisiana, in which the banks were located, imposes a tax on the capital stock of national banks, assessable against the bank. In determining the assessable value of the stock, the Louisiana law provides that the assessed value of real estate owned by the bank is deductible from what would otherwise be the value of the stock.

Over a period of 5 years the new bank, in determining the tax value of its capital stock, deducted the value of the real estate of the old bank, which had been transferred to the new bank and stood in its name, as its own property. As a result it paid in taxes $192,000 less than otherwise would have been exacted.

In *Leslie v. Commercial Nat. Bank in Shreveport*, 28 F. Supp. 927, the District Court found that the property had been transferred by the old bank to the new in pledge and therefore still belonged to the old bank. On this factual basis it held that the new bank must account to the old bank for this tax savings, even though the old bank had suffered no detriment.

The Fifth Circuit agreed with the District Judge on this phase of the case. *Commercial Nat. Bank in Shreveport v. Parsons*, 144 F.2d 231, cer. den. 323 U.S. 796. The court said:

> "* * * appellant had no right to deduct from the assessed value of its own capital stock the value of such real estate as was shown on its published statements, because it was not the owner thereof within the meaning of the statute authorizing such deductions. The credit thus obtained by the new bank was a profit derived from the trust property as effectively as if it had been paid that much in cash."

On remand the new bank sought leave to deny that the assets had been transferred in pledge and to assert that they had been transferred outright. The trial court adhered to its decision relative to the tax savings. *Connolly v. Commercial Nat. Bank in Shreveport*, 72 F. Supp. 961, 963. On a second appeal, the Court of Appeals, in banc, held that most

of the assets had been transferred outright to the new bank, but that some of the assets had not, and that the new bank must account to the old for tax savings resulting from the use of the latter. *Commercial Nat. Bank in Shreveport v. Connolly,* 176 F.2d 1004. On the first appeal there had been one dissent as to the duty to account for the tax savings. On the second appeal the court's opinion was written by the judge who had dissented on the first appeal. Thus the whole court finally concurred that there was a duty to account for tax savings to the party whose rights were used to achieve that saving.

On a third appeal, the Fifth Circuit in banc held that the New Bank must account to the Old Bank for all the tax savings, *Connolly v. Commercial National Bank in Shreveport,* 189 F.2d 608.

C. THE RETENTION OF THE BENEFITS RECEIVED BY RESPONDENT WOULD BE UNJUST FOR TWO MAJOR REASONS.

Respondent has been enriched. If the enrichment was unjust, petitioner is entitled to recover. The enrichment was unjust for two independent major reasons: (1) such retention would be a perversion of the tax laws, and (2) respondent occupied a fiduciary relation to petitioner and violated it in appropriating petitioner's loss to its own use.

We proceed to discuss each of these reasons.

III.

First Major Reason Why Retention of the Enrichment Received by Respondent Would Be Unjust: Such Retention Is Inconsistent with the Rationale of Consolidated Returns and the Purpose of Congress in Allowing Them.

The principle underlying consolidated returns — their rationale — is summarized in II Montgomery's Federal

Taxes, Corporations and Partnerships, 1946-1947 issue, at page 633, where legislative reports and similar material are quoted.[23] The principle is this: A group of affiliated corporations is an economic entity and, unless the group as a whole in the conduct of the business enterprise shows net profits, those who conduct the business—*the owners of the parent*—have realized no gain, despite the legal fiction of separate corporations. As said in *Handy & Harman v. Burnet*, 284 U.S. 136, 140, the purpose is

> "to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise, even though it was conducted by means of more than one corporation."

The rationale of consolidated returns "is the recognition of this common owner's right to set off against his gains in the one [corporation] his losses in the other [corporation]." *Duke Power Co. v. Commissioner of Internal Revenue*, 44 F. 2d 543 at 545 (4 Cir.), cer. den. 282 U.S. 903, containing an excellent statement of the history and purpose of consolidated returns and the concept of the economic unity. So also *Alameda Inv. Co. v. McLaughlin*, 28 F.2d 81 (D.C. N.D. Cal.) aff'd 33 F.2d 120 (9 Cir.).

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[23] Consolidated returns were first required, but only for excess profits tax, by Treasury Regulation in 1917. This was validated by the 1921 Act. Consolidated returns were compulsory for both normal and excess profits taxes between 1918 and 1921, inclusive. They were permissive but not mandatory for 1922-1933, inclusive. They were not permitted, except in case of certain railroad corporations, from 1934-1939, inclusive. They were permissive for all corporations with respect to excess profits taxes in 1940 and 1941. In 1942 the Revenue Act, Section 141(a), extended the privilege to all corporations for all years after December 31, 1941, with respect to both normal taxes and excess profits taxes. (For the foregoing history see II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-1947 issue, at p. 632.)

In Appendix Two to this brief we quote some of the legislative history on the subject.

When the law recognizes the group of affiliated corporations as an economic entity and permits the off-setting of the profits of one affiliate against the losses of another, it does so for the purpose and with the effect of benefiting the ultimate owners of the business entity, who are, of course, the stockholders of the parent corporation. The means which the law adopts to benefit these ultimate owners is the amelioration of the loss suffered by the ultimate owners because of losses of any one affiliate; this amelioration is accomplished by permitting the losses to reduce or eliminate, for tax purposes, the profits of other affiliates.

In the present case there are two significant facts: (1) the economic unity between the parent and the subsidiary was severed before the tax saving was claimed or achieved, (2) the saving resulted from the use of the loss which resulted from the severance of that unity. In such a case, if the tax saving is permitted to be retained by the former subsidiary after severance of the economic unity, without making restitution to the parent, particularly where the loss was that of the parent directly, both of the underlying principles of the consolidated return provisions of the income tax law have been defeated: (1) The stockholders of the parent corporation will not obtain the benefit resulting from filing a consolidated return, and (2) in addition, the loss which they suffered—and here suffered directly—will not have been ameliorated.

On the contrary, new owners of the former subsidiary will reap a profit—a sheer windfall—from the misfortune of the old owners. The income tax laws will have been used to

enrich complete strangers to the economic entity for whose protection consolidated returns are permitted. The fact that the retention of the enrichment would defeat the policy of the statute shows the enrichment to have been unjust.

In *Woolford Realty Co. v. Rose*, 286 U.S. 319, this Court (Cardozo, J.) held that the use of consolidated returns did not permit a corporation to deduct from its profits the loss of an affiliate sustained in a year prior to that in which the affiliation began. "The mind rebels against the notion," it said, "that Congress in permitting a consolidated return" was willing to permit a corporation to profit by the loss of one who was a stranger when the loss was sustained.

In the present case we have the converse situation, for here the tax savings were claimed after the economic unity was destroyed, and laws and regulations had come into effect subsequent to *Woolford* which permitted the tax saving in this case. But it is just as shocking to one's sense of justice to permit respondent to appropriate for its *own* benefit losses with which it had nothing to do, as it was in the *Woolford* case to contemplate the appropriation by one affiliate of the losses suffered by another in years prior to the affiliation.

If the economic unity had not been severed, the benefits would still inure to petitioner though retained by respondent. But "the mind rebels against the notion" that after the economic unity has been terminated, respondent may appropriate petitioner's tax credit resulting from petitioner's losses without making restitution. In the language of the *Woolford* case, "to such an attempt the reaction of an impartial mind is little short of instinctive." This "instinctive reaction" of which the Court speaks is the equivalent of

the conscience of the chancellor, the "good conscience" with which the law of quasi-contract and unjust enrichment is concerned, and which determines whether an enrichment is just or unjust. The party whose loss made the tax saving possible should receive it as a partial amelioration of its loss, rather than another who was not in good conscience entitled to any tax saving whatever.

In his dissenting opinion below Judge Fee summarized the matter thus (R. 2248):

> "If we look at it realistically, but little question arises. If the plaintiff were still the owner of the stock of defendant, then the allocation of $17,000,000 to the defendant would be reflected in the increased value of its stock. The transfer of the stock left the right untouched. Since increase in value of stock in defendant no longer is of avail to plaintiff, there should be another method of applying the remission to the loss."

In *Helvering v. Morgan's, Inc.*, 293 U.S. 121, 127, the Court said that "After affiliation, as before, the affiliated corporations, although filing consolidated returns, continued to be separate taxable units. The consolidated returns operated only to unite them for the purpose of tax computation and the equitable apportionment between them of the tax thus computed."

Equitable apportionment of the tax involves equitable apportionment of the savings, and what is equitable must be decided in the light of the fact which distinguishes our present case from all others, namely, that the corporations are in fact separate entities, not merely legally, as the *Morgan's* case indicates is true of all affiliates filing consolidated returns, but also economically and factually.

The Report of the Senate Finance Committee on the Revenue Bill of 1928, 70th Congress, 1st session, Senate Report 960, which we quote in part in Appendix Two to this brief, also stated that "Much of the misapprehension about consolidated returns will be removed when it is realized that * * * no ultimate advantage under the tax laws really results." Similarly, in the Report of the Senate Finance Committee on the Revenue Bill of 1932, 72nd Congress, 1st session, Senate Report 665, at page 9, it was said concerning consolidated returns, "No improper benefits are obtained from the privilege."

After quoting these passages, the Board of Tax Appeals in *J. D. & A. B. Spreckels Co.*, 41 B.T.A. 370, 374, 375, answered in the negative the question "whether or not the framers of the statute intended that the privilege of making consolidated returns may be enjoyed in cases where the affiliation does not serve a business purpose, as distinguished from a tax-reducing purpose."

No purpose other than a tax-reducing purpose could have been served in the present case except by applying the tax savings to ameliorate petitioner's loss. Otherwise, an "ultimate advantage under the tax laws" has resulted and "improper benefits are obtained from the privilege": respondent has escaped its taxes because an economic stranger had a huge loss. The District Court was understandably indignant at this result. "If I had the power," it asserted, "I would order these taxes paid to the United States. That would effectively dispose of the cause." (R. 270.)

Yet it left the funds with respondent, the unjustly enriched party responsible for what was done. And the majority opinion below, while disapproving the trial court's reasoning, permits its result to stand.

The consequence is that the revenue laws have been perverted and made absurd, a result wholly inadmissible under rules of statutory interpretation often stated in this Court's decisions, many of which are collected by Judge Learned Hand in *Cabell v. Markham*, 148 F.2d 737 (2 Cir.). A congressional purpose as to who should have the tax savings, apparent from its enactments, should be given effect. Cf. *United States v. Hutcheson*, 312 U.S. 219, 235; *Van Beeck v. Sabine Towing Co.*, 300 U.S. 342, 351.

THE LAW AND REGULATIONS CONCERNING JOINDER IN CONSOLIDATED RETURNS BY ONE IN RECEIVERSHIP OR BANKRUPTCY.

Section 52 of the Internal Revenue Code provides that when a trustee in bankruptcy is operating the business of a corporation, he shall make the income tax returns for it in the same manner and form as corporations are required to do, and the tax due on the basis of the returns shall be collected in the same manner as if collected from the corporation.

Treasury Regulation 104, Sec. 23.15, subd. (b), provided that if one or more, but not all, of the members of an affiliated group are in bankruptcy, the tax liability of each such member for the period covered by a consolidated return shall not exceed such portion of the consolidated tax liability as the affiliates may agree upon, or, in the absence of such an agreement, an amount equal to its liability "computed as if a separate return had been filed."

In the fall of 1942, while the *Ecker* case was on this Court's docket, Section 23(g)(4) was added to the Internal Revenue Code to permit the loss of a parent corporation resulting from worthlessness of stock of a subsidiary to be

used as an operating loss. But for this amendment petitioner's loss could not have been used to offset respondent's income.

Bankruptcy of a subsidiary usually makes the stock interest of the parent valueless and deprives the parent of control over it. However, under the foregoing provision, any stock loss of the parent resulting from the bankruptcy can be offset against the income of the subsidiary, the subsidiary being permitted to pay a tax computed "as if a separate return had been filed," thus giving the tax benefit of the parent's loss to the parent.

The several provisions of the law and regulations thus show a legislative intention that a parent whose subsidiary goes into bankruptcy, with resulting loss of the value of the parent's stock, should have the benefit of any tax saving resulting through the filing of consolidated returns and the offsetting of the subsidiary's income by the parent's loss.

Respondent's tax counsel, Polk, testified that this case could not have happened but for the addition to the Internal Revenue Code in 1942 of Section 23(g)(4), and explained its purpose thus (R. 1447):

> "* * * there was a very unfair situation in consolidated return accounting up to that point that section 23(g)(4) was designed to correct. You see, under consolidated returns inter-company transactions are eliminated, and where a parent corporation puts out its cash for a subsidiary company and then the subsidiary company becomes worthless, if you eliminate the worthlessness as an inter-company transaction, there has been, in the usual case, a deprivation of capital, a loss of capital, and no reflection for tax purposes, and that was corrected by the insertion into the Internal Revenue Code of Section 23(g)(4)."

The "unfair situation" of which Polk spoke was that the parent had lost capital but derived no tax benefit from it. The purpose of the 1942 amendment was to correct this unfairness. But to permit the subsidiary to profit, instead of having the tax saving applied to ameliorate the parent's loss, would utterly fail to achieve that purpose.

S.E.C. DECISIONS.

In point is a ruling of the Securities and Exchange Commission, entitled *"In the Matter of Consolidated Electric and Gas Company,"* 15 S.E.C. 161 (1943). That case arose under the Public Utility Holding Company Act of 1935.[24] Section 12 prohibits certain intercorporate transactions between parents and subsidiaries, and the Act requires notice of intended transactions to be filed with the Commission to give it an opportunity to pass upon them. S.E.C. Regulation U-45 prohibits certain donations between parents and subsidiaries with exceptions in the case of consolidated tax returns.

In the particular case Consolidated Electric and Gas Company filed a notice with the Commission that it and its various subsidiaries had entered into a contract whereby it was to be primarily responsible for the payment of the taxes resulting from consolidated returns and each of the subsidiaries should pay as its share an amount representing that percentage of the total consolidated taxes of the group which the tax of the particular company, computed on a separate basis, would bear to the total amount of taxes of all the parties, computed on a separate basis.

[24] Since that Act regulates gas and electric holding companies and does not apply to a railroad corporation, the Act itself is not pertinent, but the problem arising under it and presented to the S.E.C. involved principles applicable here.

A consolidated return was to be filed for 1943, and a tax saving of $2,156,804 would result from the fact that the parent had or would suffer a loss in disposing of its investment in approximately nine subsidiaries. This loss was, for tax purposes, in every respect identical with the loss sustained by petitioner here from the worthlessness of its stock in respondent.

Consolidated Electric desired approval of its determination to alter the agreement so as to permit the remaining subsidiaries to make direct payment to it of amounts equal to those that they would save under the consolidated return by virtue of the capital loss incurred by the parent company.

The Commission approved this proposal, thereby holding that it was equitable that the affiliate securing the benefit of the tax saving resulting from the parent's loss should pay the amount of such saving to the parent which had suffered the loss. The Commission said that

> "To the extent that tax savings may accrue to the parent in connection with such sales, the result is in effect to reduce the amount of loss accruing to Consolidated by virtue of the transaction" (p. 163)

and expressed its conclusion as follows:

> "Under all the circumstances, we believe that it is more realistic to view the tax savings as, in effect, partial offsets to the capital losses otherwise suffered by Consolidated in connection with the sales." (p. 164)

In the *Consolidated* case the affiliation continued. Consequently, as the Commission remarked, the savings eventually would have inured to the parent anyway by virtue of dividend payments, or, if the parent should dispose of its

stockholdings in the subsidiaries, by increasing the value of the stock. The injustice of not having the tax savings transferred immediately to the parent would therefore not have been great. Nevertheless the Commission felt that a direct transfer was appropriate. As shown in 13 S.E.C. at 653, "the announced program of Consolidated is one for the liquidation of the Consolidated system." Thus the economic unity was to be severed, and therefore the S.E.C. recognized the equity that the tax savings resulting from the use of the parent's loss go to it at once. *A fortiori,* in the present case, where the economic unity has been split so that the tax savings cannot inure to the parent by virtue of dividends, the justice of requiring respondent to transfer the tax saving to petitioner to ameliorate its loss, by virtue of which alone the savings was possible, is apparent.

In another matter before the S.E.C. involving the same parent, *In the Matter of Consolidated Electric and Gas Company,* 13 S.E.C. 649, the loss was that of Islands, one of the subsidiaries, instead of the parent. By means of consolidated returns the parent and affiliates other than Islands saved nearly $1,500,000 in taxes by reason of Islands' loss. The S.E.C. approved an application of the parent to pay to Islands an amount equal to the tax savings of the parent and other affiliates, since (13 S.E.C. at 658)

> "The tax savings * * * has its origin in a loss sustained by Islands and it seems eminently equitable that the cash be applied, as proposed, to the satisfaction of the Series A bonds of Islands, the holders of which have legal recourse against Islands alone."[25]

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[25]Respondent has sought to distinguish this case on the ground that Islands by joining in the consolidated returns would be subject to a future tax and that the arrangement was merely to put it in

Two principles are apparent from these cases: (1) the tax saving should go to the ultimate owner of the economic entity, the parent, and (2) it should go to the party suffering the loss, to ameliorate it. So long as the economic unity continues, these two principles coincide, for no matter which affiliate sustains the loss in the first instance, the parent also sustains it—at once if it is the affiliate, or ultimately if the loss was that of a subsidiary. Thus, in the *Islands* case the parent allocated the tax benefits, resulting from a loss, in a manner best serving its own interests, for by using the tax savings to pay off the subsidiary's bonded debt the parent increased the value of its own equity.

In the present case, too, both equities coincide, the equity that the tax saving should go to the parent and the equity that it should go to the party sustaining the loss, to ameliorate it. Both equities sustain petitioner's right to recover. And both demonstrate that it would be inequitable for the tax savings to go to one that was neither the parent nor the sufferer of the loss.[26]

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the same position as if it had filed a separate return. But this is not the fact, for the S.E.C. found that the amount of the future tax would "be considerably less than the tax savings to be presently effected" (13 S.E.C. at 653). The proposal was that the *whole* of the tax saving should be paid to Islands, and it was this proposal that the S.E.C. approved (13 S.E.C. at 652).

[26]Respondent's briefs below quoted from an S.E.C. release discussing accounting practice, wherein it is said that no part of tax savings is "ordinarily" paid to the loss company. The text of the release shows that the S.E.C. was not directing its remarks to a case, such as this, where the loss is that of the parent itself. Ordinarily losses are those of subsidiaries, since the parent, not being an operating company, can sustain losses only in the unusual case of worthlessness of its security holdings. The S.E.C. was referring to the normal situation of a continuing economic unity, and the alternatives noted were (a) allocation of all the savings to the affiliate having the loss or (b) sharing it. There was no mention whatever of the third course that respondent espouses—that of

PETITIONER'S RIGHT TO RECOVER IS SUPPORTED BY EQUITABLE RULES OF CONTRIBUTION.

Situations often arise where, as respects a third party to whom a duty is owed, two persons are both liable; yet, as between themselves, the burden should be discharged in whole or in part by one of them only, either because of agreement between them or apart from agreement. If one of the parties discharges the obligation, he is entitled to restitution from the other who should have done so. *Restatement of Restitution*, Section 81, Comment thereunder, and the sections following, as well as the "Introductory Note" under Topic 3 at pages 327, et seq.

As stated on page 328 of the Restatement, even if the parties do not have in mind the necessity of such restitution, or do not think of it in detail, a duty will be imposed.

These principles apply to tax situations, including those involved in consolidated returns.

Bankers Trust Co. v. Florida East Coast Car Ferry Co., 92 F.2d 450 (5 Cir.) illustrates that application. That case involved a consolidated return in which the net income of one of the affiliates, "A", was overstated, resulting in an excess tax chargeable to it of $195,000, and the income of another affiliate, "B", was understated. The tax deficiency resulting from the understatement amounted to $99,000. Offsetting the two, there was a net refund of $96,000 resulting from the overstatement.

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retention of all the savings by the affiliate whose taxes are reduced by use of the parent's loss.

The significant lesson to be drawn from the S.E.C. is that when an affiliate's tax savings resulting from the use of another affiliate's loss cannot or may not reach the party suffering the loss through ordinary channels, as by way of dividends or increase of its equity, the benefit of the tax savings should be passed to the party who suffered the loss.

One of the questions in the case was whether A was entitled to recover $99,000 from B.[27] A had overpaid that amount in addition to the $96,000 and would have been entitled to its refund from the tax authorities except for the fact that it was applied to pay the additional tax due from B. In short, A's credit paid B's tax, as a result of the consolidated reporting.

It was held that the affiliate whose income had been overstated was entitled to reimbursement in the amount of $99,000 from the receiver of the affiliate whose income had been understated.

So, in the present case, respondent's tax liability was discharged, not by its paying anything, but by use of a tax credit belonging to the petitioner.

The two affiliates in the *Florida East Coast* case were subsidiaries of a common parent. The one that had received the benefit of the other's tax credits was in the hands of receivers. Were it not for the intervention of the receivership, it would have been a matter of no practical concern whether or not the affiliate receiving the benefit of the other's credits accounted to it, because in either event the common parent would be the ultimate economic beneficiary. It would be irrelevant whether the gain reached the parent through its ownership of the one corporation or of the other, and the ultimate disposition of the benefit would lie in the parent's hands. But the insolvency of the first affiliate, resulting in the receivership, meant that the rights of that

[27] Another question was to whom the refund of $96,000 should go. This presented no problem. The refund went to A, not because A had paid the money but because the refund was due to A's own tax credits; that is, on a separate return basis the $96,000 would never have had to be paid by A.

affiliate's creditors intervened between it and its parent; there was a severance of the economic unity. If the tax benefits were allowed to remain in the hands of the receivers, they would never reach the parent. It thus became important that the incidence of gains and benefits should be placed where it properly belonged. And it was so placed in the *Florida East Coast* case by the judgment rendered.

In the *Florida East Coast* case the severance occurred because of the intervention of the rights of creditors. Here the severance occurred as the result of adjudication in 1943 that petitioner was not entitled to an equity in the reorganized defendant. The principle is the same in both cases.

If a tax liability is justly that of one party, either in whole or in part, and another discharges it, the latter is entitled to recover from the former. *Phillips-Jones Corp. v. Parmley*, 302 U.S. 233; *Wolters v. Henningsan*, 114 Cal. 433, 46 Pac. 277.

In tax cases a right to contribution from other members of an affiliated group may arise from overpayment of one's share. *Koppers Co.*, 11 T.C. 894; *Koppers Co.*, 8 T.C. 886, 891. Although all members of an affiliated group may be severally liable to the government for the whole tax, "as between themselves, each affiliate [is] mutually obligated under principles of general law to pay only its fair share of the common burden." *Koppers Co.*, 8 T.C. at 891.

In the present case, petitioner had no income and its fair share of the tax burden was nothing whatever. Since respondent's tax liability was fully discharged by the use of petitioner's tax credits, petitioner has a right to restitution for the benefit received.

SEVERANCE OF THE ECONOMIC UNITY MAY NOT BE IGNORED.

Respondent has argued that "economic unity" in matters of consolidated returns is a false factor, because a subsidiary may have bonds or non-voting preferred stock outstanding. This flies in the face of the principle upon which consolidated returns are based, namely, that a single business enterprise, though conducted by separate corporations, shall be taxed as a unit. For consolidated returns to be available, the parent must own not only 95% of the voting stock but 95% of all non-voting stock other than preferred stock limited as to dividends (I.R.C., Sec. 141(d)). In short, the parent must own what for practical purposes is the entire equity.

Holdings by others of interests which do not share fully in the equity do not affect the economic unity. If, as respondent argued, tax savings go to pay bondholders or preferred stockholders, then payment of these overriding obligations *pro tanto* lifts the load depressing the equity and correspondingly increases its value to the benefit of the parent. The economic unity continuing, precise mathematical admeasurement of the benefit to the parent is of no consequence. As said in *Estate of John B. Lewis*, 10 T.C. 1080, 1086 (1948):

> "To say that a corporation, as such, can have motives and purposes apart from its stockholders, the collective group of individuals who own it, is to indulge in metaphysical reasoning * * * And to say that what is advantageous to the stockholders * * * is of no advantage to the corporation is utterly unrealistic."

On the other hand, if the overriding load is so great that in fact there is no equity, e.g., if the subsidiary is insolvent,

the economic unity has in effect been severed. Such, for example, was the situation presented in *Bankers Trust Company v. Florida East Coast Car Ferry Co.*, 92 F.2d 450.

IV.

Second Major Reason Why Retention of the Enrichment Received by Respondent Would Be Unjust: Respondent, Occupying a Fiduciary Position to Petitioner, Appropriated Petitioner's Rights to Its Own Use.

March 15, 1943 is a critical date in fixing the relative rights, duties and obligations of the parties. Before then petitioner as the owner of all of respondent's stock and as the hopeful suppliant for the continuance of that ownership after reorganization received the advantage of any benefit that accrued to respondent. After this Court's decision affirming the denial of petitioner's claim to share in the equity of the reorganized company, everyone having to do with petitioner's affairs was under the highest obligation to see that such rights as were left to it and the rights of its stockholders were not dissipated, lost, violated or neglected. From that date those persons who, with propriety, had theretofore acted in dual capacities or as joint officers of petitioner and respondent were now under the highest obligation to see that no act and no inaction of theirs should prejudice the rights of either company against the other.

In view of petitioner's misfortune and its stricken condition, it was the high fiduciary duty of its agents to be diligent to protect its rights, to utilize every opportunity that might retrieve something for its stockholders from the debacle, above all not to permit the use of its rights, including its stock loss, for the benefit of another, without accounting.

Respondent could have openly approached and fully disclosed to petitioner the view of respondent's tax counsel that petitioner's loss could be used in consolidated returns to discharge respondent's taxes; it could then have requested petitioner's cooperation and consent to the filing of consolidated returns and use of the loss. Had this disclosure and request been made, petitioner could have obtained independent officers and counsel and the parties could then have arrived at an equitable agreement apportioning the tax saving. Such an agreement would have been an easy, simple and honorable way to settle the question.

But this was not done. No such agreement was made, *simply and bluntly because respondent took over and managed the entire tax matter for its own benefit by controlling and directing petitioner's officers and agents.*[28]

As 65 Harvard Law Review 1257 says of this case:

> "[Respondent's] enrichment may have been unjust if, having caused [petitioner] to file the consolidated returns, it deprived [petitioner] of the opportunity to bargain for the value of its corporate assets: the right to use its stock loss for tax purposes."

A. PETITIONER NEITHER MADE NOR COULD MAKE A GIFT TO RESPONDENT.

Professor Scott says of quasi-contractual liability:

> "In general one is entitled to recover for benefit conferred unless he intended to make a gift or acted officiously." (2 Scott on Trusts, Sec. 269.3, p. 1520)

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[28] The duality of position of petitioner's representatives—the fact that they were in the employ and pay of respondent—would have made an agreement between the parties impossible unless and until independent representation was obtained. No such agreement would be binding, and petitioner would still have the right to an unfettered determination of its right by the courts. See authorities on duality, discussed at pp. 89-92, infra. But respondent did not even seek an agreement. It simply appropriated petitioner's rights.

How much more so is this true where one does not voluntarily confer the benefit but where it is seized. Petitioner here made no gift of its loss to respondent. The latter simply took it. Even if petitioner's directors had realized what was being done and even if they had had a donative intent, no gift could occur.

In the first place, the duality of position of petitioner's representatives would preclude any claim of an effective corporate intent to make a gift (see authorities on duality at pp. 89-92, infra).

In the second place, petitioner's directors had no power to grant a gratuity, for stockholders' rights cannot be given away. *Brayton v. Welch*, 39 F. Supp. 537; *Greene County Nat. Farm Loan Assn. v. Federal Land Bank, etc.*, 57 F. Supp. 783. Here the real parties in interest are petitioner's stockholders.[29]

As the dissenting opinion of Judge Fee pointed out (R. 2244):

> "* * * It seems to be assumed that the officers of plaintiff could give away the property right to file or refuse to file consolidated returns either voluntarily or acting under the control of defendant or the reorganization trustees. This is strange doctrine. * * * a transfer of all the assets of a corporation * * * cannot be made even by a majority of the stock. Neither officers nor directors, without a vote of the majority, have such power. In this case it is of stellar importance that this right of plaintiff was its sole asset and that, upon appropriation thereof, it became insolvent."

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[29] Petitioner's loss being essentially its sole asset, the directors could not even have sold it without the approval of the stockholders. See authorities cited in Judge Fee's opinion (R. 2252, fn. 12, 13, 14, 15).

B. RESPONDENT AND ITS ATTORNEYS WERE FIDUCIARIES TO PETITIONER IN THE CONDUCT OF THE TAX MATTERS.

Where one corporation has been given or takes control over the property or affairs of another, and exercises it in a manner to obtain benefits for itself, it becomes accountable for those benefits, because control by the one over the property or affairs of the other creates a fiduciary duty not to use the control for the fiduciary's profit.

In the *Shreveport Bank* cases that rule was applied where the benefits were tax savings (see p. 58, supra).

Note the mechanics whereby respondent appropriated for its own benefit the tax credits resulting from petitioner's loss:

The operative documents which produced this result were (a) the consolidated tax returns for 1943 and for the first four months of 1944, (b) the claim for refund of the 1942 taxes, and (c) the power of attorney from petitioner to Polk. It was respondent, through its tax counsel, which prepared these documents. With them in hand, it was enabled to eliminate its tax liability and did so. It filed the documents and settled the tax controversy with the government, all in petitioner's name. All of these documents were signed by Curry as petitioner's president. At the time he signed them he was vice president, assistant secretary and assistant treasurer of respondent with his headquarters in its office (until May 1, 1945, when his headquarters were moved to the office of its counsel). He was receiving his sole compensation from respondent and, in the signature of these documents, he was following the directions of Polk, who was its tax counsel and who, although he later solicited and secured a power of attorney from petitioner, testified that he con-

sidered he owed his responsibility to respondent and not to petitioner.

The decision to use petitioner's loss by way of offset to respondent's income was made by respondent through its president, Elsey. That decision was carried into effect by respondent's attorney, Polk, whose directions to execute the documents were obeyed by Curry. Curry was completely subject to the control of respondent and its attorney, Polk, and Curry and Polk considered themselves to be, and they in fact were, the employees of respondent. What they did with respect to the tax returns was in law the act of respondent. Insofar as tax matters were concerned, respondent was in complete control of petitioner.

Respondent was a fiduciary because at its own instance it voluntarily took over the conduct of petitioner's tax affairs and assumed to deal with petitioner's property and rights in a manner designed to benefit itself.

It was a fiduciary because petitioner's officers, whom respondent used to appropriate the petitioner's loss, were respondent's employees and the employees of its tax counsel, and paid by it and them.

It was a fiduciary because it assumed to act as petitioner's agent. While so acting, and by use of its principal's rights, and by taking advantage of its relationship to petitioner, it received the tax benefit.

In *Brooks v. Martin*, 2 Wall. (U.S.) 70, 84, this Court notes the fiduciary character of one who manages a business for another "without consulting him in any way, and with little regard for his * * * interest * * *."

As said by Judge Cardozo in *Meinhard v. Salmon*, 164 N.E. 545, 548, 249 N.Y. 458:

"Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation. He was much more than a co-adventurer. He was a managing co-adventurer. * * * For him and for those like him the rule of undivided loyalty is relentless and supreme."

As this passage shows, it is enough to create the fiduciary relation that one voluntarily places himself in control of another's affairs.[30] *Southern Pacific Co. v. Bogert*, 250 U.S. 483, 492.

In *Overfield v. Pennroad Corporation*, 42 F. Supp. 586, 48 F. Supp. 1008, a judgment of $22,104,515 was entered in a stockholder's suit in favor of the Pennroad Corporation against the Pennsylvania Railroad and its directors, the liability of the defendants being "based upon their dealings with Pennroad's property and powers in a manner designed to benefit Pennsylvania Railroad." (42 F. Supp. 610)[31]

One becomes another's fiduciary where he assumes to and does take over and manage another's affairs. The law of quasi-contract had its very origin in that situation. Its principles are derived from the Roman law, and one of the principal classes of quasi-contract was where one took over "the management of the affairs of another" or took over

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[30]3 *Bogert on Trusts* (part 1) p. 80, quoting, states that "A party may voluntarily assume a confidential relation towards another * * *."

[31]The Circuit Court of Appeals later held the claim barred by the statute of limitations but did not question the principles declared by the district court. The same issues were involved in an earlier stockholders' suit which was then revived and settled for $15 million. *Perrine v. Pennroad Corp.*, 47 Atl.2d 479, 29 Del. Ch. 531.

the "management of common property." *Bouvier's Law Dictionary* (Rawle's Revision), Title "Quasi-Contractus." *Sandars Edition of Justinian's Institutes* (7th ed.) p. 385, Liber III, Tit. XXVII states:

> "if I take upon me the management of my neighbor's affairs * * * have things in common with others who are not my partners * * * the mere fact of my so conducting myself imposes on me certain duties which the law will force me to fulfill."

As said in *Commissioner of Internal Revenue v. Owens*, 78 F.2d 768, 773 (10 Cir.):

> "The term fiduciary is derived from the civil law. * * * It connotes the idea of trust or confidence. * * * The relation arises whenever the property of one person is placed in charge of another. McKinley v. Lynch, 58 W. Va. 44, 51 S.E. 4, 9."

In the case cited (*McKinley v. Lynch*) the court quotes from several text writers thus:

> "It is difficult to define the term 'fiduciary relation'; but * * * such a relation arises wherever a trust, continuous or temporary, is specially reposed in the skill or integrity of another, or the property or pecuniary interest, in the whole or in part, or the bodily custody, of one person, is placed in the charge of another.' "

And again:

> " 'The principles which cover the cases of dealings of persons standing in a fiduciary relation apply * * * generally, to the case of persons who clothe themselves with the character which brings them within the range of principal.' "

A mortgagee or pledgee is not ordinarily a fiduciary to the mortgagor or pledgor, *Restatement of Trusts*, Sec. 9(c)

and (b), pp. 30, 31; 1 *Scott on Trusts*, p. 70, but he is if he has control of the property. *De Martin v. Phelan*, 115 Cal. 538, 543, 47 Pac. 356. Such was the holding in the *Shreveport Bank* cases (see p. 58, supra).

The majority opinion in the Court of Appeals sweeps aside these settled principles by saying that "cases which deal with trustees, agents and partners are not controlling here as there is no contention that the subsidiary was a trustee, agent or partner" (R. 2221). This assertion ignores the fact that petitioner has contended throughout that respondent occupied a fiduciary relation to it, and was its agent and trustee.

Furthermore, "fiducial relationships * * * do not depend upon nomenclature," *Oldland v. Gray*, 179 F.2d 408, 414, cer. den. 339 U.S. 948. The term "fiduciary" is not confined to fixed classified relationships like trusts. It exists wherever confidence is reposed, particularly where there is a disparity of position. 3 *Bogert on Trusts* (part 1), pp. 82, 83. In the words of Judge Cardozo, "Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish." *Meinhard v. Salmon*, 164 N.E. 545, at 548. And see *Bogert*, p. 78.

A striking example is *Reading v. The King* [1948] 2 K.B. 268, affirmed in [1949] 2 K.B. 232 and in *Reading v. The Attorney General*, 1951 Appeal Cases 507 (reviewed in Harvard Law Review, January 1952, p. 502). Reading, a British army sergeant stationed in Cairo, would ride in uniform on trucks carrying contraband. His presence in uniform deterred the Egyptian police from investigating, and he was rewarded by large sums.

The court held that the Crown was entitled to the funds because the facilities provided by it in the shape of the uniform, and the use of the soldier's position in the army, were the reason why the payments were made to him.

It was further held that no fiduciary relationship was necessary to establish the Crown's rights, but, if one were necessary, it was present, for "the term 'fiduciary relation' in this connection is used in a * * * very comprehensive sense," and "in the wide sense in which the term is used in the relevant cases such a relation subsisted in this case as to the user of the uniform and the opportunities and facilities attached to it." ([1949] 2 K.B. at 236 and 238; [1951] Appeals Case 507, at 516)

A Corporation Which Dominates Its Affiliate Is a Fiduciary of It.

The relation between a parent and a subsidiary corporation is fiduciary, if one dominates and controls the other. The fiduciary relationship does not arise from the fact that one is a parent; it is created by the elements of dominance and the exercise of control and management. *Southern Pacific Co. v. Bogert,* 250 U.S. 483, 492; *North American Co. v. S.E.C.,* 327 U.S. 686, 693; 65 *Harvard Law Review* 1257.

Ordinarily, the parent is the fiduciary. But here respondent was petitioner's fiduciary, for it dominated and controlled petitioner's actions and directed them for its own benefit. This respondent was enabled to do because of the moribund condition of petitioner, its loss of control over respondent, resulting from the bankruptcy, respondent's reinvigorated condition, the switch of allegiance of the James Interests to respondent, and the fact that petitioner's

officers and most of its directors were mere employees of respondent and received their livelihood from it.

As said in 65 Harvard Law Review 1257, regarding this suit, "It may be strongly argued, then, that in the unique situation where the usual relationship is reversed, the subsidiary controlling the parent, the fiduciary duty is also reversed." And in *Commercial Nat. Bank in Shreveport v. Parsons*, 144 F.2d 231 at 236, "The dominant officers of the new bank were the directors of the old, and they were doubly bound to treat the latter fairly."

More than once a parent corporation has invoked and received the protection of fiduciary standards against unfair treatment at the hands of a subsidiary; e.g., *Potter v. Sanitary Co. of America*, 194 Atl. 87, 22 Del. Ch. 110; *Bancokentucky Co.'s Receiver v. National Bank etc.*, 137 S.W.2d 357, 281 Ky. 784.

C. AS A FIDUCIARY, RESPONDENT MUST ACCOUNT FOR BENEFITS GAINED.

Once a fiduciary relationship is established, the rights and duties are similar to those existing in the case of a trust. As 4 *Pomeroy on Equity Jurisprudence* (5th ed.) 263 says:

> "Wherever there is a fiduciary relation * * * the dealings of the parties with each other and with the subject-matter of the relation are governed by the same rules which determine the duties of actual trustees towards their cestuis que trustent * * *."[32]

In *Barney v. Saunders*, 16 How. (U.S.) 534, 542, the principle is stated thus:

> "It is a well-settled principle of equity, that wherever a trustee, or one standing in a fiduciary character,

[32]Thus the rule of *Cal. Civ. Code*, Sec. 2235, concerning trustees is said to apply to all fiduciary relationships. *Metropolis etc. Sav. Bank v. Monnier*, 169 Cal. 592, 598, 132 Pac. 833.

deals with the trust estate for his own personal profit, he shall account to the cestui que trust for all the gain which he has made."

In *Young v. Higbee Company*, 324 U.S. 204, a reorganization plan was proposed and confirmed by the District Court over the objection of two preferred stockholders. The two appealed. During the appeal they sold their stock and right of appeal for more than the market value of the stock. Other preferred stockholders sued them to obtain their profit. This Court held for the plaintiffs. The two stockholders, it said, had voluntarily become fiduciaries even though they had filed their objection on their own behalf and not on behalf of the preferred stockholders as a class, because success on the appeal would have redounded to the advantage of all. By appealing the two had assumed a "determining position over the rights of others" (p. 209) and "owed an obligation to them." (p. 210.) The plan of reorganization having been confirmed, the other preferred stockholders had lost nothing to which they were entitled. Yet it was held that the retention of the profit from the sale of their shares by the two stockholders was unjust; it "was not paid for anything they owned" (p. 212). So here, the tax saving now held by respondent was not the result of any tax credits belonging to it.

Pound and Plucknett's "Readings on the History and System of the Common Law" (3rd ed. 1927), at page 629, quoting Maitland's Equity, p. 83, refers to:

> "* * * one grand rule. It is this: that wherever a person clothed with a fiduciary character gains some personal advantage by availing himself of his situation as a trustee, he becomes a trustee of the advantage so gained. * * *

"The rule includes persons who are not trustees properly so called, but all those who stand in what is called a fiduciary position. * * *"

This primary principle has been stated by the authorities in much the same language regarding every variety of fiduciary situation. Its gist and substance is this: The fiduciary may not avail himself of any advantage or facility that the position gives him. If he derives any benefit either from the use of any property or rights of the beneficiary or from the fact of the relationship or from the opportunities or facilities it affords, he must account to the beneficiary for the full benefit. All profits and advantages belong to the beneficiary, regardless of whether they spring from performance or from violation of the fiduciary's duty.

The basic reason for this is that the fiduciary owes the duty of highest loyalty to his beneficiary, his personal interests must be utterly subjugated, "he must act with an eye single to the interest" of the beneficiary. And it matters not that the beneficiary has suffered no injury, that the profit was not made at his expense, or that he could not himself have made the gain. It matters not that the fiduciary acts in good faith or bad faith. Any other rule would tempt him to consider his own interest and put him in a position of conflict of selfishness with loyalty. Agreements altering these consequences may be possible, but they must follow "full disclosure of all relevant facts" and "an opportunity to obtain independent advice."

See *Restatement of Agency*, Sec. 387, 388; *Restatement of Trusts*, Sec. 203; 2 *Am. Jur.*, Agency, Sec. 268, p. 215; 3

C.J.S., Agency, Sec. 165, p. 53; 3 *Scott on Trusts*, Sec. 502, p. 2422; 3 *Bogert on Trusts* (Part 1), p. 79.[33]

"These high standards" courts are "not disposed to whittle down." *Fleishhacker v. Blum*, 109 F.2d 543, 547 (9 Cir.), cer. den. 311 U.S. 665.

These fiduciary rules are applied "with particular stringency" to dealings between interlocking corporations. *Mayflower Hotel Stock. P.C. v. Mayflower Hotel Corp.*, 173 F. 2d 416 (D.C. Cir., 1949).

The fiduciary principle has been applied to innumerable varieties of facts, many of which "do not fall readily into any general classification." (3 *Bogert on Trusts* (Part 1) p. 153.) As *Bogert* further says:

> "The ways in which a fiduciary can take a position hostile to the trust and seek a private advantage are without number. In whatever form the disloyalty appears, equity penalizes it with the privilege in the cestui of obtaining a constructive trust of the advantage obtained by the wrongdoing trustee." (p. 156)

Thus the principle has been applied to compel an accounting of tax savings (*Shreveport Bank* cases, p. 58, supra) and of bribes (*Reading v. The King*, p. 83, supra).

The majority opinion of the Court of Appeals dismissed the *Shreveport* cases on the ground that there the "new bank" had the duties of a trustee (R. 2220-1). But no trust in the strict sense was there present. There was a pledge which placed the officers in dual relationships with respect to the old and new banks. *Leslie v. Commercial National*

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[33] "Thus where a person who is in a fiduciary or confidential relation to another obtains property from the other by taking advantage of the relation, a constructive trust arises." 3 Scott on Trusts, Sec. 468, p. 2336 and cases cited.

Bank in Shreveport, 28 F. Supp. 927, 933; *Commercial Nat. Bank in Shreveport v. Parsons*, 144 F.2d 231, 233. The words "trust" and "trustees" are found in the *Shreveport* opinions only because the courts recognized with Maitland and Pomeroy that the "grand rule" binding fiduciaries (quoted p. 86, supra) "includes persons who are not trustees properly so-called, but all those who stand in what is called a fiduciary position."

The opinion of the court below concedes that if respondent dominated petitioner, it was a fiduciary (R. 2221). The district court found that there was a preponderance of evidence of such control (R. 272).

D. THE EXISTENCE OF COMMON OFFICERS REQUIRES THE HIGHEST STANDARDS OF CONDUCT IN INTERCORPORATE DEALINGS: DUALITY.

Here we have the case of a subsidiary dominating its former parent and directing its actions for its own benefit. But aside from the fact of domination and control, the existence of common officers in the two companies created a fiduciary relation.

Numerous decisions declare the equitable principles that are brought into operation by duality. For example, *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590; *Chelrob v. Barrett*, 57 N.E. 2d 825, 293 N.Y. 442; *Overfield v. Pennroad Corporation*, 42 F. Supp. 586.[34] These contain such a com-

[34]Others are: *Globe Woolen Co. v. Utica Gas & Electric Co.*, 121 N.E. 378, 224 N.Y. 483 (per Cardozo, J.); *Merger Mines Corporation v. Grismer*, 137 F.2d 335 (9 Cir.), cer. den. 320 U.S. 794; *Goodell v. Verdugo Canon Water Co.*, 138 Cal. 308, 71 Pac. 354; 3 *Fletcher Cyc. Corporations*, Per. ed., Sec. 961, pp. 433, 434; *Eshleman v. Keenan*, 187 Atl. 25, 2 A2d 904, 23 Del. Ch. 234; *Price v. Standard Oil Co.*, 55 N.Y.S.2d 890, a case where a corporation's employees were mere employees (not directors) of another corporation; annotation and cases, 114 A.L.R. 308.

prehensive discussion of the law with a review of the leading cases that no amplification is necessary.

In the *Geddes* case this Court said (p. 599):

> "'The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, * * *. Especially is this true where a common director is dominating in influence or in character. This Court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add in the soundest business policy.'"

In the *Pennroad* case the directors of the Pennroad Corporation were directors, officers or employees of the Pennsylvania Railroad, with loyalty to the latter. It was held that this was sufficient ground for the recovery from Pennsylvania Railroad of all losses incurred by Pennroad as the result of investments made under the direction of these officers and directors, despite their integrity and good faith.

Chelrob v. Barrett, supra, involved a public utility system comprising three corporations. A owned the voting stock of B which owned the voting stock of C. B sold gas to C at a price fixed by the directors of the two corporations, all of whom had been chosen by A. A majority of the directors of B and of C were also directors, and in some cases paid officers, of A, and some of the directors of A were also directors of B. Judgment was rendered directing additional payment by C to B.

The case is of particular interest because the court noted that so long as B and C earned enough to pay dividends

on the preferred stock, it was not material what price was charged for the gas, since the earnings of either eventually reached the ultimate parent, A, the owner of the common stock. The problem arose only when earnings fell off so that dividends on the preferred stock went into arrears. Thus, in the present case, it would have been unimportant whether the tax savings went to respondent or the petitioner so long as the latter owned the former. The severance of that tie created the problem.

Bernheim v. Louisville Property Co., 214 S.W. 801, 185 Ky. 63, involved common agents and officers of two corporations which had formerly been affiliated but whose interests had been severed. The court remarked on the failure of the individuals occupying dual positions to appreciate that "the severance of 1908 in reality changed the relationship between the two companies."

The principles of duality apply to every variety of situation where the same person or persons represent two or more interests—e.g., agency (cf. *Restatement of Agency*, Sec. 390, 392), trusts (cf. *Restatement of Trusts*, Sec. 170), attorneys at law (cf. *Peyton v. William C. Peyton Corp.*, 7 A.2d 737, 747, 23 Del. Ch. 321; Re *James Estate*, 86 N.Y.S. 2d 78 (1948)).

Both the *Peyton* and the *James* cases, like the present, involved the conduct of Mr. Coulson.

The consequences here of duality are: (1) equity requires respondent to account to petitioner; (2) respondent must account for the benefits received rather than petitioner's detriment; (3) the duality precludes any contention of gratuity; (4) all issues must be decided in the light of the fiduciary duties resting upon respondent, the actor; and

(5) every detail of the transaction is opened to the scrutiny of the court.

Respondent argued below that the presence of duality was not significant because some of it had its origin at a time prior to the bankruptcy proceeding when petitioner still controlled respondent. The contention is irrelevant, for the conditions extant when the relation was created no longer existed. Duality is a fact, a condition of inconsistent interests, imposing rigorous fiduciary standards of rectitude regardless of how the duality came about. A fiduciary cannot be excused from his duty of fair dealing to his principal because his principal created the relation. Otherwise the agent, the trustee, would usually be free to victimize his principal or beneficiary.

The argument that duality is to be ignored because petitioner "created the duality" is precisely the argument advanced to sustain the actions of Mr. Coulson in the case of *In re James' Estate*, 86 N.Y.S.2d 78. The court set aside certain transactions because of the duality, and it dismissed as of no consequence the fact that the duality was proper in its origin. It said (p. 84):

> "At this point the court makes note that the persons acting in these dual capacities did so by reason of the terms of the will and that no criticism may be made of their occupying the offices to which they were appointed. Such dual functions nonetheless bring into this case legal principles which exact special standards of fiduciary conduct from persons so situated."

The controlling fact was "that there did not exist independence of operation" (p. 90).

E. RESPONDENT MUST ACCOUNT FOR AN ENRICHMENT RESULTING FROM ACTS OF ITS AGENTS WHO WERE FIDUCIARIES OF PETITIONER.

We have shown that respondent was the fiduciary of petitioner and must account for the unjust enrichment resulting from the use of its position. But beyond this, petitioner is entitled to recover because the officers and the tax counsel of respondent were also agents of petitioner, openly assuming to act for it. Respondent's counsel had himself designated as "petitioner's attorney-in-fact" so that he could deal with the Treasury Department and make a settlement in its name. Petitioner's president, who signed the documents, was also respondent's employee and agent. Respondent's enrichment is a direct and immediate consequence of their act; it is an enrichment independent of the volition of petitioner. The fruits of their acts are in respondent's possession. As Judge Cardozo pointed out in *Whiting v. Hudson Trust Company*, 138 N.E. 33, 234 N.Y. 394, where a common trustee of two estates robbed one to replace funds taken from the other and the latter was held to account to the former, "We cannot characterize enrichment so procured as other than unjust."

V.

All Arguments Advanced Against Recovery by Petitioner Are Opposed to Elementary Principles

The arguments advanced against recovery by petitioner have been many and varied. The trial court ~~relied on one~~ set of arguments, the Court of Appeals relied on a wholly different set, disagreeing with the trial court *in toto*. Respondent has advanced still other arguments which both courts ignored.

A. PETITIONER WAS UNDER NO DUTY TO JOIN IN CONSOLIDATED RETURNS OR TO CONFER UPON RESPONDENT THE BENEFITS OF ITS TAX CREDITS.

The Court of Appeals based its decision on the view that petitioner was under the duty to join in consolidated returns and to confer upon respondent, gratis, the benefit of its tax credit. It therefore held irrelevant the fact that respondent took over and managed petitioner's tax affairs without consultation with petitioner or consideration of its rights.

There is no basis for the premise. As stated in 65 Harvard Law Review 1257, commenting on this case:

> "The ground relied on by the Court of Appeals was that * * * [respondent] could have violated no duty to act fairly since [petitioner] was under a duty to file the consolidated returns anyway. The court's argument that [petitioner] had such a duty, however, is not convincing. The Internal Revenue Code imposes no such obligation."

No Such Duty Can Be Found in the Tax Laws or Regulations.

No duty such as the Court of Appeals assumed can be found in federal tax laws or regulations. The tax laws in effect during the period in question make clear:

1. Only the parent corporation may file consolidated returns (Treas. Reg. 104, Sec. 23.16a).

2. There was no duty to file consolidated returns (Reg. 104, Sec. 23.11a; II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-7, pp. 649-650).

3. A parent is under no duty to a subsidiary to file consolidated returns and is free to make its own decision on the basis of its own interest. *Duke Power Co. v. Comm.*, 44 F.2d 543, 545 (4 Cir.).

4. Similarly, a subsidiary is free to refuse to join, *Geo. A. Fuller Co. v. Comm.*, 92 F.2d 72 (2 Cir.); *Trinity Building Corp.*, 40 B.T.A. 1315, although such a refusal is not likely since the subsidiary is ordinarily controlled by the parent.

Therefore, insofar as tax law is concerned, petitioner was free, in each of the years in question, to file a separate return (although its tax counsel, who were counsel for respondent, failed to so advise it, p. 27, supra). The principle and its rationale are declared in *Duke Power Co. v. Commissioner of Internal Revenue*, 44 F.2d 543, 545 (4 Cir.), cer. den. 282 U.S. 903, where it was held that a subsidiary had no right to the benefits of a consolidated return where the parent chose to file a separate return. The court there said:

> "It [the law] assumed that if there was that degree of affiliation which the law required, there was a dominant control, and *it gave to that dominant control the right to make the choice.* The argument, therefore, that this construction of the law prevents one of the group from making its election, and forces it by the conduct of its associates or its parent to a definite course against its own interest, is untenable for the reason that such an argument destroys the entire premise on which the optional provision is based. *A corporation is owned by its shareholders, who are the ultimate source of power controlling its corporate action.* If its stockholders decide that its best interests require filing by it of a separate tax return, no provision of the law denies it this privilege, but in that event the effect of its action is to deprive its associates of the benefits, if there are any, of a consolidated return, and imposes upon each the duty of filing a like

form of return, but *if all the corporations affiliated be owned by the same interests, and that of course is the presumption on which the right is made to rest, it is fair to assume that they will act harmoniously and for the interest of the common owner,* and it is the recognition of this common owner's right to set off against his gains in the one his losses in the other that induced the permitted consolidated return." (P. 545)

Since this is true when the economic unity exists, patently the parent owes no duty to a former subsidiary to join in consolidated returns for the latter's benefit, after the economic unity has been severed, merely because continuance of technical affiliation makes such returns permissible. In this case the economic unity was severed before the tax returns were filed. In the words of the trial court during the trial (R. 1380), the parties were "free agents to agree with one another to file this type of return"; that is, to agree or to refuse to agree.[35]

The Bankruptcy Court Could Not Have Compelled Petitioner to Give Its Loss to Respondent.

Certain it is that the bankruptcy court could not have ordered petitioner to join in consolidated returns and to give respondent the benefit of its loss. Not only was respondent already out of bankruptcy when the 1944 return and the claim for refund were filed, but, quite apart from

[35]Yet, oddly, when it decided the case, the trial court observed in its opinion that "there is some merit to defendant's contention that a firm obligation rested upon plaintiff to conform and cooperate" to give defendant the benefit of its loss (R. 275). But the opinion contained no suggestion of any reasons to support this view, and elsewhere the opinion asserts that the tax savings were "amazing and undeserved" (R. 276). It is impossible to reconcile the two statements. How could one be under an obligation to give another an "amazing and undeserved" benefit?

that fact, the bankruptcy court would have been without jurisdiction to make any such order. *Callaway v. Benton*, 336 U.S. 132.[36] Nor did it do so.

No Such Duty Can Be Found in Any Principle of Law or Equity.

The holding of the Court of Appeals that petitioner was under an obligation to join in consolidated returns with respondent for the latter's benefit can only mean that respondent by an independent suit in equity against petitioner could have compelled it to join in such a return gratuitously.

Thus by judicial fiat the court below makes mandatory what Congress and the Treasury left optional. Wherever consolidated returns may be filed with a resulting tax deduction to anyone, this decision decrees that they must be.

The rule so created not only confers on one corporation a right to use another's assets, but it does so free of any requirement of just compensation.

No principle supports such a right. Rather, as Judge Fee stated (R. 2242):

> "plaintiff had a property right to file or refuse to file consolidated returns, which could neither be given away without consideration nor cut off judicially without due process."

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[36]Under Section 77 (the railroad reorganization section) a bankruptcy court's *in personam* jurisdiction is confined to the debtor, here respondent. It has no jurisdiction over disputes with others not involving property in the debtor's possession. *Bankruptcy Act*, Sec. 77(a); Title 11 *U.S.C.*, Sec. 205(a); *Thompson v. Terminal Shares*, 104 F.2d 1 (8 Cir.), cer. den. 308 U.S. 559. In *Callaway v. Benton*, it was held that a bankruptcy court had no jurisdiction to compel another to transfer rights to the trustees or to enter into a contract with them.

As he further stated (R. 2243):

> "Since, under the [tax] law, all corporations concerned must consent to the filing of consolidated returns, it is clear, contrary to the statement in the majority opinion, that plaintiff had no duty requiring it to file these returns. Plaintiff had a legal right to refuse to file."

Petitioner Assumed Burdens in Filing Consolidated Returns.

There are many factors besides offset of losses which bear on the question whether it is advantageous to join in consolidated returns (cf. II Montgomery, Federal Taxes on Corporations, 1942-1943, pp. 492, 493-5). Burdens as well as advantages flow from such action. Thus each company joining in the return becomes liable for the full amount of taxes owed by the group (Treas. Reg. 104, Sec. 23.15(a); T.R. 110, Sec. 33.15(a)), and is subjected to requirements affecting its future tax situation. For example, by virtue of elimination of intercompany transactions, the basis at which property is held may be affected (T.R. 104, Sec. 23.38; T.R. 110, Sec. 33.38). In certain circumstances such returns must be filed in a later year (T.R. 104, Sec. 23.11(a); T.R. 110, Sec. 33.11(a)), although "future developments may make the filing of separate returns for future years more advantageous" (II Montgomery, p. 492). Here one consequence of petitioner's joining in the consolidated returns was to make it liable for any taxes payable by respondent. All this demonstrates how indefensible it is to hold that an independent company has any duty to assume such a liability and such possible disadvantages simply to benefit another company which wants to use its loss.

Petitioner Was Not a Fiduciary for Respondent. The Reverse Was True.

To extend its rule of mandatory filing of consolidated returns to a situation where the parent-subsidiary relationship has been severed, the court below stated that a tax return is an historical document, that a fiduciary's duties with respect to matters arising during the fiduciary relationship continues through the period of winding up, and that the fiduciary who performs an act of winding up may not exact payment (R. 2234-5):[37]

But petitioner was not respondent's liquidating agent nor its fiduciary. On the contrary, as we have just seen, respondent was a fiduciary to petitioner (p. 79, supra). By controlling petitioner's president so as to file the tax returns, respondent assumed a "determining position over the rights" of petitioner and thereby "owed an obligation to it." *Young v. The Higbee Co.*, 324 U.S. 204, 209, 210. What makes one a fiduciary for another are the elements of dominance and the exercise of control and management. *Southern Pacific Company v. Bogert*, 250 U.S. 483 at 492; *North American Co. v. S.E.C.*, 327 U.S. 686 at 693; 65 *Harvard Law Review* 1257.

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[37]The authorities cited in the opinion are not pertinent. They are *California Corporations Code*, Sec. 15030; *Uniform Partnership Act*, Sec. 30; 3 *Scott on Trusts*, Sec. 344; 16 *Fletcher, Corporations* (Perm. ed.) Sec. 8174; *Trice v. Comstock*, 121 Fed. 620. The first two provide that, on dissolution, a partnership is not terminated but continues until winding up is complete. The third states that a trustee's duties and powers do not cease until the trust is wound up. Fletcher on Corporations notes that in many jurisdictions by statute corporate directors upon dissolution continue as trustees for liquidation. In *Trice v. Comstock*, it was held that an agent was accountable to his former principal for a profit made after the termination of the agency, in buying land as a result of information and advantages acquired because of his agency and while agent.

The majority opinion itself noted that after 1935 respondent "was no longer controlled by Corporation but by the trustees appointed by the bankruptcy court" (R. 2223) and that after adoption of the Plan of Reorganization "affiliation no longer existed" (R. 2231). The plan cut off all possibility of a return of control, management, or financial interest. The loss arose from the plan. The prior association could not impose the duty on petitioner to make a free grant to respondent of the only asset which the reorganization left petitioner, i.e., the tax utility of its loss.

The Court of Appeals deduced a duty to join in consolidated returns and to give the benefit of its loss from a fiduciary relationship of petitioner to respondent. From what did it deduce that relationship? Merely from an assumed duty to join in consolidated returns. This is reasoning in a circle.

Common Officers May Not Sacrifice the Rights and Assets of One Corporation for the Benefit of the Other.

The court below justified its holding that petitioner was bound to join in consolidated returns for respondent's benefit by stating that "the dual officers owed fiduciary duties to both corporations to promote the interests of both and to obtain for each what it was entitled to under the tax laws" (R. 2232, 2233). No doubt common officers owe a duty to each corporation to protect its rights and further its interests. But it does not follow that in promoting the interests of one corporation, its officers may use the rights and assets of another of which they are also officers, without compensation.

If the common officers and attorneys were bound to inform respondent that it could save taxes if it could get

petitioner to join in returns, they were equally bound to tell petitioner that its loss could be used to save respondent taxes and that petitioner was under no duty to join in a consolidated return to permit this to be done. They could not expropriate the utility of the loss.

Conflict with the Second and Fourth Circuits and Tax Court.

To justify its conclusion, the court below asserts the converse that, if the loss were respondent's and the income petitioner's, the latter could have compelled respondent to confer upon it the benefit of the loss by joining in consolidated returns (R. 2223). If sound, this would mean that petitioner could have gone into the bankruptcy court, which had jurisdiction over respondent, and obtained an order compelling the bankruptcy trustees to join in consolidated returns and to confer upon petitioner the benefit of the trustees' losses, without any compensation whatever. Had petitioner applied for such an order in such a situation, the trustees obviously would have insisted that the loss and the right not to join in the returns were assets upon which it was their duty to realize for the benefit of creditors, and the bankruptcy court would have inquired what compensation petitioner offered.

The assumption by the court below that respondent would have had to join with petitioner is in conflict with the Second and Fourth Circuits and the Board of Tax Appeals which have held that a corporation, including one in bankruptcy, is free to join or not to join in consolidated returns as it sees fit.

In *George A. Fuller Co. v. Commissioner*, 92 F.2d 72 (2 Cir.) and *Trinity Building Corporation of New York*, 40

B.T.A. 1315, the Commissioner was upheld in refusing to accept consolidated returns filed by a parent and several subsidiaries, because the trustees of a bankrupt subsidiary had refused to join. *Duke Power Co. v. Commissioner*, 44 F.2d 543 (4 Cir.), cer. den. 282 U.S. 903, reached the same conclusion as to such returns filed by two subsidiaries where the parent refused to join. The taxpayers were thus unable even to utilize the losses of those who did join.

No Duty Such as the Court of Appeals Postulates Can Be Extracted from the Rights of Respondent's Pre-Reorganization Creditors.

In support of the alleged duty of petitioner to give its tax rights away, respondent has argued, and the majority opinion below seems to accept the argument, that respondent's pre-reorganization creditors were not paid in full and that creditors have an absolute priority over stockholders. But the conclusion sought to be drawn is a sheer *non sequitur*. The creditors did receive absolute priority. Petitioner, the stockholder, did have its equity completely wiped out as well as its creditor's claim for $7,750,000 of advances. The old creditors became the owners of all of the bonds and all of the stock of the reorganized company.

By reason of swollen war time traffic, those former creditors received benefits, advantages and equities vastly beyond the expectations of the plan of reorganization (see pp. 53-55, supra).

Creditors of a reorganized company, after wholly supplanting the former shareholders, as they did here, no matter under what sanction of law, have no right to appropriate still other property of the former shareholders. The reorganized respondent certainly could not have with impunity seized $17 million cash of petitioner to pay its taxes,

merely because the pre-reorganization creditors had not been paid in full.[38]

Respondent's argument is merely another facet of the contention that petitioner is seeking something in the nature of equity or value for its former stock ownership. As we have shown, the contention is unsound (p. 49, supra). Petitioner has accepted in full the consequences of the plan of reorganization. The plan wiped out the entire stock ownership of the old stockholder. But its consummation, having stripped petitioner of that ownership, left it with something in its place—its stock loss, which had a tax utility. It was then that respondent went beyond the plan and appropriated what petitioner had left.

The Alleged Duty Is Incontrovertibly Refuted by Considering the Situation of a Corporation Having Income.

If petitioner had earned $75 million in other enterprises in 1942, 1943 and 1944, its stock loss would have eliminated its tax on that income, and no one would have the temerity to suggest that it could have been compelled to give the benefit of its loss to respondent. If a prosperous corporation, e.g., Standard Oil Company, rather than petitioner had owned respondent's stock, no one would claim that it had to join in the consolidated returns and confer on respondent, gratis, the tax utility of its loss, since Standard could use

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[38]Petitioner was controlled, prior to respondent's bankruptcy, by the James Interests who owned 61% of its common stock (but only 8.8% of its preferred stock) (Chart, P 1). These were the controlling human agents responsible for what occurred. As the result of respondent's reorganization the James Interests became the controlling power in respondent. If petitioner's suit is defeated, the effect will be that the James Interests, the common stockholders in petitioner, will profit from the tax utility of petitioner's loss in preference to petitioner's preferred stockholders.

the loss to discharge its own taxes. The very suggestion shows the absurdity of the contention that petitioner was under a duty to do so.

As Judge Fee stated in his dissenting opinion below (R. 2251):

> "An incontrovertible proof of the proposition that plaintiff had no duty to apply the loss for the benefit of defendant may be cited. If plaintiff had sold a gold mine for a profit of over $75,000,000.00, its loss on the stock of the subsidiary could have been applied to offset any taxes against plaintiff. In that event, the trustees in reorganization would have been required to pay taxes against the operating company. Once used, the power of applying the loss would be functus officii, and plaintiff would have received the entire benefit."

The fact is so self-evident that in its ~~briefs below respondent felt obliged to~~ say that "if during the critical years the plaintiff had * * * taxable income * * * plaintiff would have a different case."[39]

B. PETITIONER'S RIGHT RESTS ON BENEFITS CONFERRED AND IS NOT CONFINED TO DETRIMENT SUSTAINED. ONE'S PROPERTY OR RIGHTS CANNOT BE APPROPRIATED MERELY BECAUSE THE OWNER CANNOT USE THEM PROFITABLY HIMSELF.

Thus the argument has reduced itself to the contention that unless petitioner could have used its loss to its own

[39]Petitioner owned 50% of the stock of the Denver & Rio Grande Western Ry. Co., which was wiped out by a plan of reorganization of that railroad at about the same time as its holdings in respondent were similarly treated (p. 7, supra). If petitioner's Denver & Rio Grande stock had not been wiped out, and instead it had income on that stock, it could have used its Western Pacific loss to save taxes thereon. Certainly no right sprang up in respondent to appropriate the tax utility of that loss because petitioner also sustained a loss of its Denver & Rio Grande stock.

advantage, it could be compelled to give it away. Respondent has urged that petitioner lost nothing because it had no use for its tax loss, that therefore it has no cause of action, or that if it has a cause of action, the recovery would be limited to the amount of petitioner's damage, which was nil.

The court below supported its position by this fallacious reasoning. It based its judgment on the fact that petitioner was so unfortunate as to be left destitute with no taxable income and therefore had lesser rights than if it were prosperous.

Referring to the fact that respondent dominated petitioner and directed its officers so as to appropriate its rights to respondent's advantage, the court asserted that respondent "did not abuse its supposed dominant position because the officers and directors common to both corporations did not sacrifice Corporation's [petitioner's] interests to those of its subsidiary" (R. 2232). The reason given for this assertion is that petitioner "had no income" and so "there was no possible way for it to achieve any tax advantage to offset the loss," whereas "its affiliate [respondent] did have use for the loss" (R. 2232). "Under this state of facts these officers had the positive duty to make use of the loss as they did" (R. 2233), that is, to give it to the respondent, who used it to save the taxes it otherwise must pay.

No authority was cited for this conclusion; nor does any exist. It is merely an assertion that a corporation which dominates another may appropriate its tax credits without compensation simply because it can profitably use them while the dominated corporation cannot.

Many a person may have use for another's property or rights, but it has never heretofore been held that he may

therefore appropriate such rights or property without compensation. A man's right to protection of his assets from seizure or trespass by another does not depend on what use or profit he himself could make of them. The contrary rule has reflected itself in a multitude of instances and in numerous branches of the law.

Suits for the Use of Land.

United States v. Bernard, 202 Fed. 728 (9 Cir.) declares the fact that land has not been injured and "that a plaintiff in an action for continued trespass would have made no use of the land which the defendant has wrongfully used to his advantage and profit will not prevent the plaintiff from recovering the actual value of that which has been so used and acquired by defendant" (p. 731).

In Unjust Enrichment Cases Recovery Is Measured by Benefit Received.

A plaintiff's rights in an unjust enrichment case are measured by the benefits conferred, received or taken — the "enrichment," not the detriment suffered. *Restatement of Restitution,* Section 1, and comment. In the comment it is said:

> "Ordinarily the benefit to the one and the loss to the other are co-extensive, and the result of the remedies given under the rules stated in the Restatement of this Subject is to compel the one to surrender the benefit which he has received and thereby to make restitution to the other for the loss which he has suffered. * * * [p. 13]
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> * * * * * * *
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> "In other situations, a benefit has been received by the defendant but the plaintiff has not suffered a corresponding loss or, in some cases, any loss, but never-

theless the enrichment of the defendant would be unjust. In such cases, the defendant may be under a duty to give to the plaintiff the amount by which he has been enriched." (p. 14)

In *Reading v. The King* [1949] 2 K.B. 232; *Reading v. Attorney General* [1951] Appeal Cases 507, discussed at pp. 83, 84, supra, the Crown was held entitled to bribes received by a soldier although it had sustained no loss and it could not itself have earned the sums involved. The Court of Appeals held that the Crown could recover "whether or not [it] had suffered any detriment in fact"; and that the defendant "cannot be heard to say that * * * the plaintiff suffered no loss. The plaintiff, whether actually harmed or scatheless, is conclusively presumed not only to have been damnified but to have been damnified to an extent measured by the amount" of defendant's enrichment. The House of Lords repeated that "the fact that the Crown * * * has lost no profits or suffered no damage is, of course, immaterial and the principle so well known that it is unnecessary to cite the cases illustrating and supporting it. It is the receipt and possession of the money that matters, not the loss or prejudice to the master" ([1951] A.C. at 516).

A striking application of these rules of unjust enrichment will be found in the *Kentucky Cave* case, *Edwards v. Lee's Adm'r*, 96 S.W.2d 1028, 265 Ky. 418 (1936). There Edwards had discovered a cave the entrance to which was on his land. By years of advertising and exploitation he spread the fame of the cave, improved it, built a hotel near its mouth, and eventually secured a stream of tourists whose entrance fees yielded him a good profit. Without his efforts the cave would have remained useless.

After the cave became profitable, a neighbor sued on the ground that approximately 1/3 of the length of the cave underlay his land and recovered judgment requiring an accounting of 1/3 of the net proceeds received from exhibiting the cave over a period of 7 years, plus interest.

The Supreme Court of Kentucky affirmed the judgment although it recognized (1) that plaintiff merely had a hole in the ground which he himself could not use because it was so far beneath the surface that it could not be entered except through the natural mouth on defendant's property; (2) that the cave was therefore of no practical use to the plaintiff; (3) that for the same reason there was no one in the world other than defendant himself upon whom the plaintiff might confer a right of beneficial use of the portion of the cafe under his property; (4) that consequently plaintiff's portion of the cave had no utility to him, it had no sales or rental value, and plaintiff had not been ousted of the physical occupation or use of his property because he could not and did not occupy it; (5) that the property had not in any way been injured by the use to which defendant had put it, and (6) that plaintiff had suffered no loss or detriment.

The court stated that, as the case was *sui generis*, it was left to fundamental principles and analogies. It reasoned (1) that plaintiff had something (a definite segment of the cave) and therefore was possessed of a right which it was the policy of the law to protect; (2) that the action was in equity for an accounting; and (3) that the "measure of recovery in this case must be the benefits, or net profits, received by the appellants from the use of the property of appellees," by way of analogy to the rule of Section 136 of the Restatement of Restitution.

Respondent has tried to distinguish this case as one of trespass. But the court refused to treat it so, for the reason that, had it done so, there could be no recovery for lack of "damage"; the property had not been injured, and there was no rental value since plaintiff had no access to the cave, could not use it, and there was no ouster of possession (96 S.W.2d 1028, 1030-1032).

Moreover, that case cannot be so distinguished because here respondent's use of petitioner's rights was not consensual. Long before petitioner's loss was allowed as a deduction by the government in 1947, respondent had been put on notice of petitioner's claims by the filing of the suit and by the letter of May 5, 1947 (p. 25, supra). Nevertheless, respondent persisted in using petitioner's loss in defiance of its claim.

Bearing in mind that respondent simply appropriated petitioner's tax credits without discussion and without any consideration of its rights, Section 136 of the *Restatement*, relating to benefits tortiously acquired, is also applicable. In the comment under that section, it is said:

> "In some cases, however, no harm is done and in these cases if the sole remedy were by an action of tort the wrongdoer would be allowed to profit at little or no expense. * * * The usual method of seeking restitution is by a bill in equity with a request for an accounting for any profits which have been received * * *." (p. 553)

Even where a defendant has not acted in a manner considered to be tortious he may have to account under the principles of quasi-contract. *Restatement of Restitution*,

Ch. 6. The law on the subject is not static or confined to ancient categories.[40]

Where a Fiduciary Profits from the Relationship.

Similarly, where a fiduciary gains a profit from the fiduciary relationship, it belongs to the beneficiary, regardless of whether the latter could have made it independently.[41]

It is elementary, as said in 3 *C.J.S.*, Sec. 165, page 54, that the application of the fiduciary rules discussed at pages 85-89, supra,

> "is not affected by the fact that the principal did not suffer any injury by reason of the agent's dealings * * *."

Or, as said in 3 *Scott on Trusts*, Sec. 502, page 2422:

> "It is immaterial that the profit was not made at the expense of the beneficiary or principal * * *."

To the same effect are 2 *Scott*, p. 1098 and 54 *Am. Jur.* 249.

In *Young v. The Higbee Co.*, 324 U.S. 204 (discussed p. 86, supra), plaintiffs recovered defendants' gains, although plaintiffs had lost nothing and had not been damaged.

In *Fleishhacker v. Blum*, 109 F.2d 543 (9 Cir.), cer. den. 311 U.S. 665, it was held that the bank in whose behalf a stockholder's bill had been brought was entitled to re-

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[40] As said in the *Restatement*, at page 493:
"The situations dealt with in this Chapter do not exhaust all those in which restitution can conceivably be granted for benefits lawfully acquired. They represent situations which have arisen, and indicate the type of situations in which restitution should be granted."

[41] *Restatement of Restitution*, at page 15, states:
"So also, where a person in a fiduciary relation to another makes a profit in connection with transactions conducted by him as fiduciary, he is ordinarily accountable to his beneficiary for the profit, although the beneficiary suffered no loss."

cover certain profits "even though the bank has suffered no damage."

The *Shreveport Bank* cases discussed at pages 58-60, supra, make clear that the fact that one has a tax credit or advantage which he cannot use does not give another the right to use it to his advantage without accounting for its benefit. There the Old Bank, not being engaged in business, would have had no tax to pay and therefore had no way to use its property. Yet, as there said: "The fact that the Old Bank suffered no loss * * * makes no difference." *Leslie v. Commercial Nat. Bank of Shreveport*, 28 F. Supp. 927 at 933. In the first appeal in that case the dissenting judge commented: "The transaction left the old bank no worse off. It was not injured in the least by the transaction * * *." 144 F.2d at 245. Yet, on the second appeal the same judge wrote the opinion of the court, affirming the right of the old bank to recover such of the tax savings as were attributable to that class of property which it held belonged to the old bank.

S.E.C. Case.

In the *Consolidated Electric-Islands* case, discussed at page 70, supra, losses of Islands, one of the affiliates, resulted in a tax saving to the affiliated system. The S.E.C. recognized that "none of this saving can be realized directly by Islands since it does not have the taxable net income against which to offset such losses" (13 S.E.C. at 652). While it was noted that the use of the loss for tax purposes might, in a future contingency, result in a tax liability to Islands, it was also noted that "any tax liability resulting to Islands * * * will be considerably less than

the tax savings to be presently effected." Nevertheless, it was held proper that the whole of the tax savings should be paid to Islands by the other affiliates which achieved the savings by use of Islands' loss in consolidated tax returns.

The Utility to Respondent Gave Value to Petitioner.

The law recognizes that there are cases where "the nature of the material * * * involved is such that no value attaches thereto aside from the use thereof, and that once such material is used the value therein is gone," *Stanley v. Columbia Broadcasting System*, 35 Cal.2d 653, 667, 221 Pac.2d 73. The value to him who has consumed the material by using it then measures the recovery.

65 Harvard Law Review at 1257 comments:

> "[petitioner's] stock loss was an asset having value * * * even though [respondent] was the sole market and [petitioner] could utilize the stock loss in no other way."

In *Truncale v. Universal Pictures Co.*, 76 F. Supp. 465, directors of a corporation held options to buy its shares at a fixed price. Under tax law and regulations, if such an option were exercised at a time when the market price exceeds the option price, the excess was taxable income, but the corporation might deduct the excess in computing its own tax. In order to secure a closing agreement from the Commissioner of Internal Revenue that the excess, in the event the options should thereafter be exercised, would not constitute taxable income to the directors, the latter caused the corporation to agree with the Commissioner that in computing its own income it would not deduct the excess. Closing agreements to this effect were executed, and the options were then exercised.

As a consequence, the corporation paid more taxes than it should have, and the tax liabilities of the directors were diminished. However, the losses suffered by the corporation were much less than the gains enjoyed by the directors, since each director had his own outside income and the amount of his tax savings was affected by his own tax bracket.

A stockholder's derivative action was brought against the directors to compel them to account to the corporation not merely for the amount of the losses suffered by it, but for the entire tax savings of the directors. Defendants moved for a summary judgment on the ground of the statute of limitations. This turned on whether recovery was limited to the loss suffered by the corporation or extended to the entire gain enjoyed by the defendant. The court (Rifkind, J.) held the latter. Remarking that the situation was unique, it said (p. 469):

> "* * * where a corporation has the freedom to do an act or to refrain, the doing of the act, enabling others to derive benefits in excess of the losses suffered by the corporation, has a 'sale' value of which the ceiling is the amount of such benefits; * * *."

Petitioner's rights here are far stronger than that of the corporation in *Truncale's* case. There the corporation had nothing to contribute, and possessed nothing, other than the power to refuse to enter into the closing agreement. Here petitioner possessed not only the power to decline to enter into consolidated returns, but by entering into such returns it contributed something that belonged to itself, to wit, its own loss.

Respondent has tried to distinguish the *Truncale* case as a mere example of the rule that corporate directors are not allowed to profit at the expense of their corporation. But the court stated that it had to decide the case on more fundamental principles, because it did not fall within the class of cases where a corporate officer has taken for himself what could have been a corporate advantage or opportunity (76 F. Supp. at 468, 469). The plaintiff was held entitled to all of defendant's gain because "the corporation has been deprived of its freedom of action" even though the corporation could not itself have obtained all of such gain (p. 469).

That Only One Person May Have a Use for Property Does Not Give Him the Right to Appropriate It.

Closely related to respondent's argument that petitioner was not damaged, is its argument that there was no general market for petitioner's loss, since it could be used to offset income of someone other than petitioner only in a consolidated return and therefore could be availed of only by respondent.

The fact that a particular asset or right has a limited utility or "market," or that only one person can use it, does not destroy its value or give that party the right to appropriate it.

Thus in the *Shreveport Bank* cases, supra, only the new bank was able to make use of the tax credit. In *Truncale v. Universal Pictures Co.*, supra, no one but the directors were able to make use of their corporation's situation. In the absence of utilization by them the corporation could not have realized the benefits which they received. In the *Ken-*

tucky Cave case, in all the world only the defendant could make use of plaintiff's part of the "hole in the ground" (see pp. 107-109, supra).

Cases of Eminent Domain.

For example, the government may be the only possible buyer of a given property and unless it sees fit to buy, the owner may have no way to utilize the property or to realize upon it. But that fact does not destroy its value. In *James v. Campbell,* 104 U.S. 356, 358, the court noted that "Many inventions relate to subjects which can only be properly used by the government, such as explosive shells, rams, and submarine batteries to be attached to armed vessels," but observed that the government could not use such patented inventions or the patents without paying just compensation.

In the field of eminent domain generally, the fact that property has no general market and that therefore there is no market value does not eliminate its value. As said in *Boom Co. v. Patterson,* 98 U.S. 403 at 408:

> "Property is not to be * * * regarded as valueless because he [the owner] is unable to put it to any use. Others may be able to use it * * * Its capability of being thus made available gives it a market value which can be readily estimated."

As said in *San Diego Land etc. Co. v. Neale,* 78 Cal. 63, 68, 20 Pac. 372,

> "But it is certain that a corporation could not for that reason appropriate it for nothing."

In the Field of Patents and Literary Property.

In the patent field many an invention consists of an improvement or addition to a machine or process on which

another owns the patents, and it has no utility except as part of that machine or process, so that no one except the owner of the machine or process can make economic use of it. Yet the latter cannot appropriate the new invention without paying for it. As said in *Bigelow v. R.K.O. Radio Pictures*, 327 U.S. 251, 265, if "a wrongdoer has incorporated the subject of a plaintiff's patent or trademark in a single product to which the defendant has contributed other elements of value or utility, and has derived profits from the sale of the product," not only must he pay but he may have to account for all his profits. Cf. *Westinghouse Co. v. Wagner Mfg. Co.*, 225 U.S. 604.

"There are times when heed must be given to value for use, if reparation is to be adequate," *Sinclair Refining Co. v. Jenkins*, 289 U.S. 689, 699.

The same principles are applied to literary property. *Universal Pictures Co. v. Harold Lloyd Corp.*, 162 F.2d 354, 368, et seq.; *Stanley v. Columbia Broadcasting System*, 35 Cal. 2d 653; 221 Pac. 2d 73.

C. RESPONDENT'S CLAIMS THAT IT COMMITTED NO WRONG AND THAT PETITIONER HAD NO PROPERTY RIGHT ARE NOT VALID.

Respondent has contended that a "loss" is a "negative" factor and is not "property" and therefore petitioner has no rights.

Petitioner not only had the loss, it had the right to make use of the loss for tax purposes and the right to permit or withhold consent to its use in consolidated returns. This loss was not a negative factor because the tax laws made it of positive value. The tax laws provided that this loss could be used in certain circumstances to pay taxes. Therefore this loss had a value. It acquired value in precisely the same

way that anything acquires value, to wit, because it had a valuable use. (See quotation from *Boom Co. v. Patterson*, 98 U.S. 403, 408 at p. 115, supra). The loss was actually used in this case to discharge a tax liability of $17 million.

The realization of a loss has tax values. It gives rise, for example, to the right in certain circumstances to distribute tax-free dividends, to receive tax-free revenues in the future, and, with carryovers and carrybacks, it represents the right to earn a roughly equivalent amount tax-free income in the future and to recover taxes already paid. No one enjoys sustaining a loss, but no corporation which has sustained one would agree to be treated as if it had not. The tax laws attach new consequences to both income and loss: income becomes a source of liability to pay taxes, a loss furnishes the basis of obtaining a benefit and thus is a thing of value or an asset.

Respondent's Tax Saving Did Not Result Automatically from the Tax Law; It Required the Use of Petitioner's Loss in Consolidated Returns.

Respondent has argued, and the court below has asserted, that the saving of taxes arose from the fact that the taxpayer had a legal right to take the deductions allowed by law. But the savings did not arise automatically from the tax law. The only reason why the law did not require respondent to pay taxes was that it appropriated and used petitioner's loss and rights to satisfy its tax liability. Respondent could not have utilized those rights unless it could cause petitioner to file consolidated returns with it. The permission given by the tax statutes to file consolidated returns did not itself save taxes. It gave to petitioner's loss a valuable use, which petitioner was legally free not to donate

to respondent. Petitioner could have refused to join in and file consolidated returns, but it was made to act under respondent's control and domination and at its direction.

Petitioner Had a "Property" Right.

Respondent has argued that petitioner's loss, its right of use, or its right to withhold consent to the use of a consolidated return whereby the loss could be utilized, cannot be denominated "property" and therefore petitioner has no right of recovery. But terminology, such as "property," is not the source of legal or equitable rights. The reverse is true: in the long history of Anglo-American law the recognition that a right exists and is entitled to legal protection has been the starting point of recognition of new kinds of property rights.

In *United States v. Willow River Co.*, 324 U.S. 499, a plaintiff claimed a right to recover by denominating something as "property." The court said (at p. 502): "We cannot start the process of decision by calling such a claim as we have here a 'property right'; whether it is a property right is really the question to be answered."

As stated by Chief Justice Shaw (in *Boston and Lowell Railroad Corporation v. Salem and Lowell Railroad Co.*, et al., 2 Gray (68 Mass.) 1, 35 (1854)), the term "property"

> "is *nomen generalissimum*, and extends to every species of valuable right and interest, and includes real and personal property, easements, franchises and incorporeal hereditaments."

As was said in *Johnston v. 20th Century-Fox Film Corp.*, 82 C.A.2d 796, 817, 18 P.2d 474,

> "As society has developed there has been a corresponding evolution in the development of property

rights. Matters considered as near revolutionary a few years ago are now accepted as facts. Legal history shows a continual recognition of new interests and a gradual willingness to protect interests in intangible things. (Warren & Brandeis, 4 Harv. L. Rev. 193; 4 Ford. L. Rev. 307; 45 Yale L. J. 520)."

The famous article of Mr. Louis Brandeis (later r. Justice Brandeis) and Mr. Samuel Warren just referred to, which first appeared in 4 Harvard Law Review in 1890, entitled "The Right to Privacy," contains a masterly discussion of the subject. (See particularly pp. 193 to 195, and p. 212.) In *Matarese v. Moore-McCormack Lines*, 158 F.2d 631 (2 Cir.), defendant made use of an idea of the plaintiff. The idea was not only an intangible, it was unpatentable. Thus plaintiff had, in a technical sense, no "property right." But defendant was compelled to account for the savings it achieved in the cost of doing longshore work resulting from the use of the idea.

Regardless of Terminology, Petitioner Should Recover.

Whatever it may be denominated or however it may be characterized, the loss here was petitioner's; it carried with it the right of use in certain situations to achieve tax savings, and that right belonged to petitioner. Respondent appropriated that right and thereby achieved a benefit for which it should now account.

The principles on which petitioner is entitled to recover are not novel; they are fundamental. All that is novel is the factual situation. But equity is not powerless to cope with unusual facts.

Respondent has argued that petitioner's claim cannot be subsumed under any of the traditional headings of common-law liability. Respondent divides the field into categories, such as contract, common-law tort, or common-law status such as guardian and ward, and argues that the claim does not meet the definition of any one of these categories and therefore cannot exist or be enforced.

This type of argument has been repeatedly and unsuccessfully made for centuries. Had it been successful the development of the law would have ceased long ago. No doubt when equity was first asked to enforce a trust, the claim was made that the cestui que trust had no property right, for the full title was in the trustee—an argument which was promptly met by the creation of a right *in personam* to obtain restitution from the trustee.

Likewise the mortgagee claimed that he had full title to the mortgaged property, as indeed he had, and the law recognized no "property right" in the mortgagor; but this did not prevent courts of chancery from enforcing an equity of redemption, in order that justice might be done.

So when relief was sought against unfair competition and other injuries to the good will of a business, it was said that "good will" was not a right referable to any specific property and was therefore not entitled to legal protection. In a narrow sense this was true, for judges could not define good will any more definitely than "the expectation that the old customers would come to the old shop." Neither trespass nor conversion would lie but relief was given against the appropriation of what equitably belonged to the claimant.

D. RESPONDENT MAY NOT RETAIN THE ENRICHMENT BY REFUSAL TO RECOGNIZE THE SEVERANCE OF THE ECONOMIC UNITY AND BY INVOKING ALLEGED "PAST PRACTICE."

The respondent has rested heavily on a so-called past practice of petitioner and respondent to file consolidated returns in earlier years. This indeed is a principal buttress of the majority opinion of the Court of Appeals. That practice is without significance for the following reasons:

First: The relationship of petitioner and respondent was completely changed by this Court's approval in 1943 of the I.C.C.'s Plan of Reorganization. Prior to that time petitioner was respondent's owner. Thereafter they were total strangers to each other. A practice once followed between husband and wife is not pertinent to what should be done between divorced spouses. As Judge Fee pointed out, dissenting (R. 2248):

> "It is said, although there are no findings, that the history of prior consolidated returns is controlling. Of course, it cannot probably [properly] be shown how plaintiff heretofore dealt with a consolidated return after there has been a divorce from a subsidiary."

The trial court itself had said (R. 1377):

> "I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns, because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them * * *. What we have in this case is not concerned with that."

Respondent's own insistence that the "pre-reorganization The Western Pacific Railroad Company" and the "reorganized The Western Pacific Railroad Company" are

different entities (see p. 33, supra) answers the argument about past practice. While respondent is the same corporate entity before and after reorganization, the capital stock was owned by different people after the reorganization than before (p. 34, supra).

So long as the economic unity between the parties continued, a decision to file consolidated returns was that of the parent; the profits, gains or benefits of the subsidiary, or its losses or detriments, flowed to petitioner's stockholders sooner or later, since it was the owner of the economic unity. It was a matter of indifference where the benefits or detriments happened to fall in the first instance or whether a subsidiary accounted to the parent for any tax savings resulting from the use of the parent's tax credits or, instead, those savings inured to the parent through its ownership.

This Court's decision and the order of confirmation severed the economic unity. After March 15, 1943, respondent was no longer in any real sense the same party which had filed consolidated returns with petitioner in the years prior to 1942. Consequently, "past practice" is irrelevant.

Second: "Past practice" is also irrelevant because there was no practice whatever in prior years that has any relation to the facts of this case. The loss used to produce the tax savings was the loss of the parent's stock in the subsidiary. Yet (1) it was not until the amendment to the tax law in October, 1942 that this kind of loss could be utilized at all in the premises (see p. 8, supra). And (2) use of that loss to eliminate the former subsidiary's tax was "paradoxical" (see p. 19, supra); although the loss was the result of the severing of the economic unity, the sub-

sidiary was enabled to use it by reason of the tax concept of consolidated returns which has its rationale in the existence of that unity.

Since the tax law did not permit such a loss to offset operating income until October 1942, there could be no prior practice on use of such a loss.

Third: Petitioner's loss with its utility for tax saving was its sole asset. There was no past practice about giving away a sole asset.

Fourth: In the years 1936-1941, inclusive, neither petitioner nor respondent had taxable income, both had losses, and on a separate return basis neither would have had to pay a tax (R. 2040; R. 2041). What happened in those years could have no bearing on the only practice that could conceivably be relevant—whether a subsidiary had in the past accounted to the parent for tax savings resulting from use of the parent's credit.

In the years 1930-1935, while the parent had some net income, the respondent had losses, so that the subsidiary was not saved from taxes by the parent's tax credits (R. 2040, 2041).

The years prior to 1930 are too remote. Prior to 1922 consolidated returns were mandatory under the tax laws, so that a different question would have been involved. From 1923 through 1929, in only two instances (1925 and 1928) did the parent's loss result in tax savings to defendant subsidiary and then for only slightly more than $20,000 (R. 2041), of which petitioner received the benefit as owner of the enterprise.

In still earlier years a subsidiary group did account to the parent for the savings. In the years 1918-1924 the

Utah Fuel group was a subsidiary of petitioner. In 1923, for example, Utah Fuel's tax on a separate basis would have been $131,744.72. By use of the parent's loss in consolidated returns, the tax for the whole group was only $71,268. Utah Fuel paid this sum to the government, and $60,475 to petitioner. Thus it paid the full $131,744. There were similar occurrences in the other years. These facts are demonstrable from defendant's Exhibit 40, pp. 2, 3, 6, 13.

Fifth: The only respect in which past practice could conceivably be relevant would be in the construction of a contract entered into by parties with each other. But in this case there was no such contract. Respondent simply took over and carried through the tax matters without agreement. What was done prior to the critical event of the severance of the economic unity cannot evidence a contractual consent to what was thereafter done in circumstances utterly different, involving a kind of loss which never before could have been the subject of tax deductions. It cannot possibly be deemed an authorization from petitioner's board of directors to give away its sole asset to strangers.

E. RESPONDENT MAY NOT RETAIN THE ENRICHMENT ON THE THEORY THAT PETITIONER COULD NOT HAVE MADE AN AGREEMENT WITH IT ABOUT ALLOCATION OF THE TAX SAVINGS.

The respondent, the trial court, and the majority opinion of the Court of Appeals have each asserted that petitioner and respondent could not legally have made an agreement with each other for allocation of the tax savings. Each assigned a different reason.

Thus the trial court said: "In the final analysis, plaintiff's hope to succeed here depends upon whether it could have

lawfully acquired these unpaid tax moneys by voluntary agreement between the directorates of the two companies. In my opinion, it could not" (R. 274). The reason then assigned for this conclusion was that such agreement would "nullify the reorganization plan." We have shown there is no merit in that reasoning (p. 49, supra). In denying the right to have made any agreement, the majority opinion of the Court of Appeals rests on the quite different ground that petitioner was under an absolute duty to confer the use of its loss on respondent, gratis. We have already answered that argument (p. 94, supra).[42]

Respondent's ground was still a third one—that it would be against the public policy of the tax laws. Thus in its brief in opposition to the petition for certiorari it deprecates "the sort of bargaining about tax losses which is demanded here." It would be, indeed, a convenient form of morality and public policy that would permit respondent to appropriate petitioner's tax credits but which simultaneously would prohibit it from accounting for the benefits.

In fact, petitioner's rights do not depend on whether an agreement could have been made prior to the realization of the tax saving. In quasi-contract the obligation does not arise from consent but, in the absence of consent, from natural equity. *Matarese v. Moore-McCormack Lines*, 158

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[42]The court's opinion also repeatedly uses the word "tribute" to describe petitioner's desire to realize the value of its asset. But it is not duress or coercion for one to say that he will do what he has a right to do. *Marshall v. Packard Bell Co.*, 106 C.A.2d 770, 774, 236 Pac.2d 201. Nor is it a case of demanding tribute for one to refuse to confer a benefit on another except for compensation where he has a right to refuse to confer it. *Sekulow v. 11th & F St. Valet*, 162 F.2d 19 (D.C. Cir.); 5 *Williston on Contracts* (Rev. ed.), Sec. 1606; *French v. Shoemaker*, 14 Wall. 314, 334.

F.2d 631 (2 Cir.). Story's Equity Jurisprudence (14th ed.) points out (vol. 3, p. 303) that the question is not whether money has been received by a party of which he could not have compelled the payment but whether he can now with a safe conscience retain it. In *Reading v. The King* [1949] 2 K.B. 232, aff'd *Reading v. Attorney General* [1951] Appeal Cas. 507, discussed pp. 83, 84, supra, no valid prior contract to share bribes would have been possible. In the *Shreveport Bank* cases, discussed pp. 58-60, supra, no valid contract would have been possible between the Old Bank and the New Bank to report the former's property as the latter's in order to save taxes. And a fiduciary must account to his beneficiary for his gains even though made in an illegal enterprise with respect to which no agreement would be permissible (see discussion, pp. 129, 130, infra). In *Koppers Co.*, 8 Tax Court 886, it is noted that where one pays taxes which another ought to pay, "the right of contribution is not founded upon contract."

Moreover, an agreement between parties to a consolidated return concerning allocation of taxes or advantages is perfectly proper and not unusual. The propriety of such an agreement has always been recognized by the income tax law and regulations. Former revenue acts provided that the taxes under a consolidated return were to be assessed to the respective corporations in such proportions as they might agree upon and prescribed no other basis unless the parties failed to agree.[43] Under the present law the matter is left to Treasury regulations (*Internal Revenue Code*, Sec. 141, Subd. b). These regulations recognize such agreements so

[43] Act of 1921, Sec. 240(b), 42 Stat. 260; Act of 1924, Sec. 240(b), 43 Stat. 288; Act of 1926, Sec. 240(b), 44 Stat. 825.

long as they do not lessen the liability of any affiliate to the Treasury, the whole tax being assessable against any one of the corporations joining in the return (Reg. 104, Sec. 23.15(a)). Sec. 23.15(d) recognizes an agreement even though it limits liability of any one corporation to the Treasury, if that affiliate is in bankruptcy.

The propriety of voluntary agreements between parties is further shown by *Truncale v. Universal Pictures Co.*, 76 F. Supp. 465, discussed at pages 112-114, supra, by the two cases before the Securities and Exchange Commission involving the *Consolidated Electric* system, discussed at pages 68-70, supra, and by an order entered on July 29, 1947, in the United States District Court for the Eastern District of Missouri in railroad reorganization proceedings entitled "*In the Matter of Missouri Pacific Railroad Company, Debtor,*" No. 6935 (unreported). There a parent railroad owned all the stock and bonds of a group of affiliated railroads, known as the "Gulf Coast Lines." It also owned all the stock of another company, the International. All of these companies were debtors in the same bankruptcy proceedings and were operated by the one trustee. Separate tax returns for 1946 would result in no tax for the International but in a liability of over $2,500,000 for the Gulf Lines, but under a consolidated return International's loss would reduce the tax liability of the others by over $2,000,000.

Since all the parties were operated by the same trustee, an agreement by him in his capacity of trustee for one of the group with himself as trustee for the others required approval of his court (because of duality). For that reason he applied to the court to approve an arrangement whereby a consolidated return would be filed and the Gulf Lines

would pay to International about $1,860,000 of their resulting tax savings in consideration of International's joining with them in the return. The court approved the arrangement. The basis of the allocation in that case is not relevant, because it was ~~reached by~~ mutual agreement, but the case is relevant as showing the propriety of an agreement on the subject.

F. RESPONDENT MAY NOT RETAIN THE ENRICHMENT ON THE THEORY THAT THE TREASURY SHOULD NOT HAVE ALLOWED THE USE OF PETITIONER'S LOSS TO OFFSET RESPONDENT'S INCOME.

The theory stated in the caption was the major ground of the trial court's judgment. It was not advanced by respondent, for obvious reasons, and it was rejected by the Court of Appeals. We therefore discuss it but summarily.

Whether the tax savings should have been allowed by the Treasury was not an issue in this case. The case starts with the fact that there were tax savings. Their existence is part of the factual context of this litigation. The issue is: As between petitioner and respondent, who is entitled to them?

The tax question whether the loss was usable to reduce taxes had been determined by the proper administrative officials, and the tax settlement had become final before the judgment in the District Court (see p. 26, supra). The tax laws authorize the Commissioner to enter into compromises. And as said by the Attorney General (31 Op. Atty. Gen. 459), it is *his* power to do so "where, in *his* judgment, such compromises were for the interests of the United States." The Bureau of Internal Revenue was the instrumentality selected by Congress for the purpose. *Bull v. United States*, 295 U.S. 247, 259.

A determination by the instrumentality chosen by Congress is not lightly to be questioned, even in case of a direct

attack. *U. S. v. Pierce Auto Lines*, 327 U.S. 515, 535; *In re Epstein*, 4 F.2d 529, 530 (6 Cir.). Where an attack is collateral, arising merely because the results of the administrative determination are involved as one of the facts of the case, that determination is not to be questioned. Cf. *In re Kaufman's Estate*, 10 N.Y.S. 2d 616; *In re Mayer's Estate*, 22 N.Y.S. 2d 468. In the present case there was not even a collateral attack.

But even were the tax deduction improper, that could be no reason to deny relief to petitioner. To do so would permit the wrongdoer to profit from its own wrong, as Judge Fee pointed out below (see p. 37, supra).

If the trial court had in mind the principle that a court will not intervene between joint wrongdoers, that doctrine has no application. The tax matter was handled in its entirety by respondent and its counsel, and petitioner was not a participant in the handling of the tax returns and the settlement. During the settlement of the findings the trial court stated that "There is no question about that" (see p. 30, supra).

It is a settled rule of equity that if one person uses property or rights of another to make a profit, particularly if he is a fiduciary, the other person—owner or beneficiary—is entitled to the profits even though they have emanated from an illegal or improper enterprise in which the property or rights were embarked. The fiduciary cannot escape accounting on the plea of illegality of the enterprise. Thus in *Barney v. Saunders, et al.*, 16 How. (U.S.) 534, this Court reversed a judgment that refused to compel trustees to account for usurious interest received. It said:

> "They cannot be allowed to aver that the profits made on the trust fund should be put in their own

pockets, because they were unlawful gains, for fear that the conscience of the cestui que trust should be defiled by participation in them. To indulge trustees in such an obliquity of conscience, would be holding out immunity for misconduct and an inducement to speculate with the trust funds, and put them in peril." (p. 543)

And see *Daniel v. Daniel*, 116 Wash. 82, 198 Pac. 728.

In the *Shreveport Bank* case, discussed at pages 58-60, supra, the new bank used as tax deductions for state tax purposes certain property belonging to the old bank. In achieving its tax deductions the new bank made false reports to the state, i.e., it reported that the property was its own. Its tax savings thus rested on a false statement of fact. Had the truth been reported, the state would not have allowed the deductions, as the district court stated (28 F. Supp. 927, 933). Nevertheless, the court upheld the old bank's right to recover.

In *Reading v. The King* [1949] 2 K.B. 232, *Reading v. Attorney General*, 1951 Appeals Cas. 507, discussed at pages 83, 84, 107, supra, the Crown was held entitled to moneys received by an army sergeant as bribes for assisting in violations of the law of Egypt. The profits resulted from an illegal enterprise, and the Crown itself could not have engaged in that enterprise. The court held that fact no bar to the Crown's rights, and no reason to let the wrongdoer keep the enrichment.

This is in accord with what Mr. Justice Story said in 3 Story's Equity Jurisprudence (14th Ed.) Sec. 1663, p. 303:

"One of the most common cases in which a Court of Equity acts upon the ground of implied trusts in in-

vitum is where a party has received money which he cannot conscientiously withhold from another party. * * * And therefore whenever any interest arises, the true question is, not whether money has been received by a party of which he could not have compelled the payment, but whether he can now, with a safe conscience, ex aequo et bono retain it."

G. PETITIONER IS NOT BARRED BY NON-PRESENTATION OF ITS CLAIMS TO THE BANKRUPTCY COURT.

In its brief in opposition to the petition for certiorari, respondent contended that petitioner's claims were cut off, though valid, because not presented to the bankruptcy court in respondent's reorganization proceedings. This defense was strenuously urged in both courts below and it was adopted by neither, but it was pointed out by Judge Fee in his dissent in the Court of Appeals as without merit.

Petitioner's Claims Arose After the Revesting of the Railroad Properties in Respondent.

Liabilities and obligations arising from use of another's property or rights by a post-reorganization company may be enforced without impairment by reason of the reorganization proceedings. *Seaboard Air Line R. Co. v. Savannah Union Station Co.*, 181 F.2d 267 (5 Cir.).

As said in *Texas and Pacific Railway Company v. Johnson*, 151 U.S. 81 at 103:

> "* * * we are aware of no principle which would justify us in holding that a court, under the circumstances which existed here, could part with its jurisdiction over property by the complete surrender thereof to its owner, and at the same time constructively retain jurisdiction over such property so as in

that respect to bind those who would otherwise be unaffected by its orders."

Here the reorganization court did not even purport to reserve jurisdiction to supervise claims arising after the revesting.[44]

As said by Judge Fee below,

> "It is inconceivable that a decree of reorganization prevents the company, when released from tutelage, from entering into engagements and incurring liabilities. Otherwise, the reorganization would be perpetual. See *In re Portland Electric Power Co.*, 97 F. Supp. 857, 873." (R. 2252, fn. 10)

Petitioner's claims arose after the reorganization. The properties revested in respondent on December 31, 1944, and the trustees then surrendered control of operations to it (R. 2215). The claim for refund of 1942 taxes, as well as the 1944 tax return, was filed thereafter (R. 2217). The trustees had nothing to do with either. Respondent argues that the income to which the returns pertained accrued while the railroad was being operated by the trustees. But respondent assumed the obligation to pay the taxes on that income by the "Assumption Agreement" required of it under the "revesting order" (see p. 52, supra). The liability thereafter remaining was respondent's, not the trustees'. It was the reorganized respondent, not the trustees, who then utilized petitioner's loss and rights to avoid paying taxes and to discharge that liability.

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[44]Nor could it. As said in *Reese v. Beacon Hotel Corporation*, 149 F.2d 610 at 611: "* * * reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization is beyond the power of the reorganization court." Here the plan was formulated, approved and confirmed before anything was done that eventually led to the tax savings. Cf. *Callaway v. Benton*, 336 U.S. 132.

As respects the 1943 taxes, as well as those just mentioned, a claim for an accounting of the tax savings could not accrue before there were tax savings, i.e., before August, 1947, when the Treasury accepted the returns pursuant to a settlement wholly negotiated and effected by respondent after it emerged from the reorganization, as the District Court found (R. 262, 468). And it accrued when respondent refused to account. The failure to account was the wrongdoing.

Among the assets which the trustees turned over to respondent in December 1944 were $7,100,000 in government bonds, earmarked as a reserve for the payment of 1943 taxes. The tax savings resulted from the subsequent acts of the respondent in adopting the returns as filed, and in the name of petitioner prevailing upon the tax authorities to accept them. For example, respondent's Annual Report for 1944, issued in May, 1945 (5 months after it was out of reorganization), refers to the reserves as maintained to protect respondent in the event of a "ruling adverse to the company's contention that it was not liable for any Federal income or excess profits taxes for the calendar year 1943 and the first four months of 1944" (R. 514). Note that mention is here made of the respondent Company, not of the trustees.[45]

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[45] The 1943 returns had been filed, not in the name of the trustees, but in the name of respondent as an affiliate of petitioner, and the returns were signed, not by the trustees but by Mr. Elsey as respondent's president. (See in P 4A the "Return of Information and Authorization and Consent of Subsidiary Corporation Included in a Consolidated Income Tax Return.")

The Plan of Reorganization itself contemplated that, vis-à-vis the creditors who were to become the stockholders of the reorganized Company, the income after January 1, 1939 was to be treated as if the reorganized Company had come into ownership and possession of the properties on January 1, 1939 (R. 2183, para. 7).

As respondent's witness, Mr. Polk, testified, "this was a doubtful item and it was not until the Bureau had finally allowed the settlement that I knew that we had the benefit of it" and "* * * any action [about tax savings] was premature until the liability to the government was determined. You cannot calculate any savings until you know * * * the liability under the returns as filed" (R. 1459, 1460).

The Bureau's field examiner concluded in May, 1946, that the deduction should be disallowed.[46] Tax counsel then took the matter up with the Internal Revenue Agent in Charge. In order to do this, he had to procure a power of attorney from petitioner through Mr. Curry (R. 1424). Obtaining and utilizing the power of attorney was an act of the respondent, not of the trustees.

After an adverse decision by the Agent, the matter was taken to the office of the Commissioner of Internal Revenue in Washington and there settled in 1947 (R. 1426, et seq.). None of this involved any acts of the trustees.

In 1947 and before the tax settlement was made, respondent was advised in writing by petitioner that it expected an accounting of the tax savings, if respondent succeeded in having the government accept the returns as filed (p. 25, supra). Respondent had its choice then whether to seek to have those returns accepted or not. The tax savings were the result of its action at that time.

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[46]The government's audit of the returns did not even become active until the latter part of 1945 (R. 1419), the field examiner did not complete his work of examining the returns until May 1946 (R. 1423), and the audit was not completed by April 1947 (R. 1788).

Respondent Assumed All Liability for Petitioner's Claims.

Even if it could be said that the liability was created in part when the trustees filed the consolidated returns for 1943, respondent assumed that liability by the Assumption Agreement. As Judge Fee said (R. 2253, fn. 18), "defendant cannot escape under any theory since it is under bond to pay all claims against the trustees."

The bankruptcy court decreed no bar of claims except such as may be found in the "revesting order" of November 27, 1944 (R. 36). Paragraph 11 of that order fixed the date of the consummation of the plan as December 29, 1944, and provided that "the said Railroad Company shall thereupon be forever released and discharged from all of its debts, obligations and liabilities, except as herein provided" (R. 51, 52).

This was no bar to the present claim, for two reasons. First, the bar relates to "its" debts, i.e., those of the railroad company existing at the time reorganization proceedings commenced in 1935, not to claims arising from the trustees' acts. Second, the revesting order expressly excepted from its bar certain obligations. In paragraph 8 it "authorized and directed" defendant "to execute and deliver * * *

> "(a) agreement providing for the assumption of certain obligations, liabilities, contracts, agreements and leases of the debtor and the debtor's Trustees, substantially in the form attached to this order as 'Exhibit D', the form and provisions of which are hereby approved;". (R. 45, 46).

An Assumption Agreement was then executed by respondent in December, 1944. Therein defendant agreed to

"2. *Assume* any and all outstanding current liabilities and obligations incurred by said Trustees * * * and *generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business*, including liabilities and obligations hereafter arising up to midnight December 31, 1944." (R. 1711, 1713)

By order of May 21, 1945, approving the trustees' final report, the bankruptcy court found in paragraph 4 that by the Assumption Agreement the "Debtor Company assumed and agreed to perform all contracts, leases, agreements, liabilities and obligations of the Trustees remaining in effect on December 31, 1944" (R. 1987, 1988).

On November 15, 1948, Mr. Coulson submitted his bill to respondent for $300,000 for tax services rendered in part to the trustees in connection with the subject matter of this suit (R. 1749), and he was paid. No one asserted that that claim was barred by non-presentation to the bankruptcy court.

Moreover, claims arising from the trustees' acts could not be barred for failure of presentation without giving notice. Any attempt to do so would violate due process. *In re Central R. Co. of New Jersey*, 136 F.2d 633 (3 Cir.), cer. den. 320 U.S. 805; *In re Glenn-Colusa Irrigation District*, 62 F. Supp. 651 (N.D. Cal.). "Notice is a very essential feature of the Bankruptcy Act if the rights of creditors are to be limited or curtailed," *Investment Building v. Finance Co. of America*, 105 F.2d 345 at 347 (3 Cir.). And see *Texas & Pacific Railway v. Johnson*, 151 U.S. 81 at 103.

No notice was given to claimants to present any claims arising from the trustees' operations, as distinguished from claims existing against the debtor at the time proceedings were instituted in 1935. Nor did the court make any order directing that such notice be given. No such order was made because no bar was intended. The absence of such an order and of notice confirms that the Assumption Agreement was intended to be as broad and as complete as its language indicates.[47]

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[47]The purpose of bankruptcy and reorganization proceedings is to discharge or readjust debts existing at the commencement of the proceedings, not to destroy claims arising from acts of the court's officers. Proceedings under the railroad reorganization provisions of the Bankruptcy Act (formerly Section 77, now 11 U.S.C., Sec. 205, 49 Stat. 911) are essentially enlarged receivership proceedings. 5 Collier on Bankruptcy (14th ed.) p. 467. The provisions of the act "carr[y] with [them] the application to railroad reorganizations of decisions and authorities applicable to receiverships." 5 Collier 493.

The practice in railroad receiverships was well settled when Section 77 was enacted. When the assets of the debtor were sold, the purchaser was required to assume all liabilities arising from the receiver's acts, although the receiver himself was personally discharged. Cf. *Hanlon v. Smith*, 175 Fed. 192; 1 *Clark on Receivers* (2d ed.) Sec. 494, at p. 677. When the assets were returned to the debtor, enriched or bettered by the receiver's acts or operations, the party receiving them was held liable for the claims arising out of the receiver's acts even though the claims were not presented to the receivership court within a time fixed by it. Cf. discussion in *Bartlett v. Cicero Light, Heat & Power Co.*, 52 N.E. 339 at 341, 342; 177 Ill. 68; also 1 *Clark on Receivers* (2d ed.) p. 1008.

Leading cases are *Texas & Pacific Railway Company v. Johnson*, 151 U.S. 81, and *Texas & Pacific Railway Company v. Bloom*, 164 U.S. 636, where this Court emphasized that two purposes are to be served when a receivership is to be closed: (1) the receiver should be protected; but (2) all just claims arising from his conduct should be also protected. These purposes were there attained by construing a bar order as cutting off the receiver's personal liability and precluding subsequent recourse in the receivership proceedings but as not precluding recourse in any other competent

VI.

Respondent May Not Retain the Enrichment by Denying That It Dominated and Controlled Petitioner's Officers. To the Extent That the Court of Appeals Proceeded on the Premise of Lack of Such Domination and Control, It Exceeded Its Appellate Office.

As we have seen, the majority opinion in the Court of Appeals held that petitioner may not recover although respondent appropriated its rights by dominating and controlling it But concurrently the majority asserted that petitioner, not respondent, filed the tax returns and that respondent did not dominate and use petitioner's officers.

The trial court repeatedly found, both formally and informally, that respondent did dominate petitioner and used petitioner's name to avail itself of the tax credits. Its views were expressed more than once on this issue (see pages 27-

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forum against the party receiving the assets, despite lack of filing of the claims in the receivership court.

At the instant of time when any plan of railroad reorganization is being consummated there are four possible claims of liability that may be in existence, viz.: (1) liability of the debtor itself for its own debts and liabilities, i.e., the debts existing at the commencement of reorganization proceedings; (2) liability of the property and assets of the debtor in the hands of the trustees to pay claims of stockholders as such and to pay claims of creditors of the debtor existing at the onset to the bankruptcy; (3) personal liability of the trustees arising from their operations; and (4) liability of the property and assets to pay obligations arising from the trustees' operations.

11 *U.S.C.*, Sec. 205(f) provides for discharge of the first three classes of liabilities on transfer by the trustees of the properties formerly held by them at consummation of the plan of reorganization. But, consistent with previous equity principles, no provision is made for freeing the property from liability created by the trustees' operations. Furthermore, the Act (11 U.S.C., Sec. 205(c)(7)) makes provision for requiring claims existing against the debtor to be presented in order to determine who may participate in any proposed plan of reorganization. But it has no reference to claims which may subsequently arise from operations of the trustees, particularly such as arise after the plan has not only been formulated and adopted but also put into effect, as here.

31, supra, where they are set out in some detail). And there can be no question that the record required these findings (see statement of facts at pp. 10-27, supra). We shall not repeat our statement of the facts other than to show that the assertion in the majority opinion of the Court of Appeals is not a statement of fact but a conclusion based on irrelevancies.

A. THE ASSERTION THAT THERE WAS NO DOMINATION AND CONTROL HAS NO SUPPORT IN THE RECORD; IT CANNOT BE SUBSTANTIATED AND IS SIMPLY A CONCLUSION BASED ON IRRELEVANCIES.

The assertion in the majority opinion is actually a conclusion based on the alleged past practice of filing consolidated returns and a statement that the returns were prepared under the supervision of petitioner's president and independent tax counsel, and that everyone acted in the open (R. 2226).

Thus the court asserted that what was done was "in accordance with past practice of the group and under the supervision of the Corporation's president, as in former years" (R. 2226). We have shown that "past practice" is irrelevant (pp. 121-124, supra). Premised on this alleged "past practice," the opinion states that petitioner's officers, by which it can only mean Curry, acted in conformity with petitioner's "policy and directions" (R. 2229). But the undisputed facts, and they were so found in the trial court, are as follows:

Curry signed the various papers without consulting petitioner's Board of Directors and without being advised that the corporation was free not to sign. The Board did not know that petitioner's loss was being used in consolidated returns to offset respondent's income. It did not even know

that the loss could be used for tax purposes. (See pp. 14, 27, supra)

When the majority opinion states that the consolidated returns were filed by petitioner, it can mean no more than that petitioner's figurehead president, Curry, a clerk in respondent's employ, signed them in its name on the instruction of respondent's counsel, Polk, who prepared them. "Tax matters were wholly Greek to me" Curry testified (R. 808). Resting on the irrelevant past practice, the majority opinion further states that in prior years Curry had "supervised preparation of consolidated returns." But even then he had supervision only in the sense that he was office manager; he had no understanding of the returns (R. 807-809).

The majority opinion remarks (R. 2225) that Mr. Polk wrote a letter in May 1943 to Curry stating the possibility of using petitioner's loss. The letter was addressed to Curry as vice-president of respondent, not as an officer of petitioner (R. 588, 589). Nor did it advise that the loss could be used. It merely "commented rather than suggested * * * since it is paradoxical" (R. 591). Not until December 1943 did respondent's tax counsel decide in his own mind that tax law would permit use of the loss (R. 1448, 1484). He did not then or ever advise petitioner. Instead he came to San Francisco to advise respondent, and the decision to use the loss by filing a consolidated return in petitioner's name was made by respondent's president, Elsey (R. 1448, 1268).

Respondent's counsel then wrote it an opinion concerning the use of the loss (R. 606). No copy went to petitioner or to Curry (R. 665). The various papers were then prepared under the direction of respondent's tax counsel, Polk. Curry

had no part in their preparation. He signed on counsel's direction (R. 663, 667, 1418, 1442).

The majority opinion asserts that the use of the loss was not concealed, and that "everybody knew that consolidated returns were being filed" (R. 2226).[48] While directors knew of the filing of consolidated returns, they did not know of the use of the loss (see p. 14, supra). That use was never revealed to petitioner's governing body, its board. The fact that a trespasser does not conceal his trespass does not absolve him. There must be consent by the party on whose property the trespass is made. Consent requires revelation, knowledge and agreement.

The majority opinion further bases its conclusion on the statement (R. 2226) that the filing of consolidated returns and the use of petitioner's loss "was under the guidance of independent tax experts" (R. 2226). The adjective "independent" has no meaning in the facts of this case. These experts were Mr. Polk and his partners in the law firm of Whitman, Ransom, Coulson & Goetz, who had long been and were the attorneys for the James Interests. They became the tax attorneys of respondent a week following this Court's decision approving the reorganization plan. They were compensated solely by respondent and were paid $300,000 for their services in advising and directing the filing of consolidated returns and the use of petitioner's loss. They were also reimbursed for the moneys they had paid Curry following the closing of the New York office when he and petitioner's files were removed to the office of Polk and Coulson. Polk's recognition of his status as attorney for

[48] For this statement the court cites a remark of the trial court made about half way through the trial, not a finding.

respondent, working solely in its interests, is shown by his testimony why he had ignored petitioner in carrying on the settlement negotiations with the Treasury; Polk testified "My responsibility was to them [respondent] and not the corporation [petitioner]" (R. 1431). How his firm could be "independent" it is difficult to conceive.[49]

B. THE COURT BELOW MADE FINDINGS AB INITIO TO AFFIRM THE JUDGMENT UPON A LEGAL THEORY DIFFERENT FROM THAT ON WHICH THE TRIAL COURT ACTED, AND THESE FINDINGS WERE CONTRARY TO WHAT THE TRIAL COURT MADE CLEAR IT WOULD HAVE FOUND, HAD IT CONSIDERED THE ISSUES MATERIAL, AS WELL AS CONTRARY TO THOSE ACTUALLY MADE.

Two things are clear: (1) The trial court found that respondent dominated petitioner and used the latter's officers. (2) That is the only possible deduction from the facts found and from the record. Even if this were not true, then, as pointed out in 65 Harvard Law Review at 1258, commenting on this case, the moment "the issue of control [is] determinative of whether there could be recovery * * *, it would seem necessary for the court to have remanded to the district court for findings on that issue."

[49]For these facts, see pages 15-17, 21-26, supra. The majority opinion remarks further that the employment of the "independent tax experts" was upon the suggestion of petitioner's general counsel, Mr. Nicodemus. At that time Mr. Nicodemus was also an attorney for respondent (R. 1032), and his suggestion was that respondent employ tax counsel, not that petitioner do so (R. 544). Even if Mr. Nicodemus thereafter knew of the use of the loss, a corporation loses none of its properties or rights because it has an attorney who is also attorney for the party who appropriates them. In fact, Mr. Nicodemus testified that he did not know of the use of petitioner's loss until December 1945 or early 1946 (R. 1072-1073), long after the last return. If the issue of his knowledge were relevant, a finding thereon can only be made by the trial court. Without having heard the witness, an appellate court cannot find against his testimony. The trial court stated that the issue was "incompetent, irrelevant and immaterial." (R. 1076).

This is not a case where an appellate court has reversed a judgment because it believes the findings to be "clearly erroneous." What occurred here is, so far as we can find, unprecedented. Here an appellate court, sweeping aside a trial court's legal theories as unsound, has affirmed on a theory presupporting a set of facts contrary to what that court has found either formally or informally by stating that it would have so found had it deemed them material, after hearing the witnesses and presiding over a living trial.

Nor is this a case where an appellate court, in affirming a judgment on a legal theory different from that of the lower tribunal, does so on the basis of facts found below. Here the legal theory is new and rests on facts found *ab initio* by the the appellate court.

The majority opinion says (R. 2235):

> "The record is barren of evidence to support the contention that Corporation was dominated by the subsidiary, or that there was a breach of any duty owed to Corporation. As the trial court stated, 'The so-called "duality of control" much discussed and emphasized, is not important.' "

A casual reading of this extraordinary statement would suggest that the trial court had found absence of domination. But what the trial court said in its opinion, which it adopted as its findings, was this (R. 272):

> "Whether there was, or was not, 'duality of control' respecting the directorates of the two companies, appears to me to be not too important. *True, there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control.'* "

And by "duality of control" it said that it meant,

> "that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant." (R. 264)

The trial court declined to make a formal finding on any facts not material to the two legal theories on which it based its decision.[50] It concluded that "there is little factual dispute pertinent to the issue decided," i.e., pertinent to its legal theories (R. 276), and that "The so-called 'duality of control,' much discussed and emphasized, is not important in resolving the tendered issue," i.e., the issue deemed by it to be important (R. 274).

But, while declining to amplify its findings formally, the trial court, after hearing all the witnesses and performing the function which the law assigns to a trial court, made clear that, had it believed the issue material, it would formally find in accordance with petitioner's claim, i.e., that respondent controlled petitioner and by means of that control caused it to file the consolidated returns for respondent's benefit. On the settlement of the findings it said that "there is no question about that" (see p. 30, supra). The importance which this Court attaches to a trial court's ability to see the witnesses face to face is shown by *United States v. Oregon Medical Society*, 343 U.S. 326, 339 (April 28, 1952).

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[50]Contrary to an assertion in the majority opinion below, the trial court gave permission to counsel to submit findings only if they were limited to the issues relevant to its theories (R. 276).

The Court of Appeals held that the trial court erred in what it considered the "essential equitable considerations" and in its two legal theories, and therefore that its findings did not support its judgment.

Judge Fee's dissenting opinion clearly states the situation presented by that holding (R. 2241):

> "Thus the two grounds advanced [by the Trial Court] to sustain the judgment fail. The cause should be reversed for failure to state adequate findings to support the judgment. Findings must be made in the Trial Court. Appellate courts have no such right or function. The majority opinion attempts to accomplish justification of the result below by drawing inferences, deductions and conclusions from evidence which they claim to find in the record. It would be possible for other judges to set up a diametrically opposite set of facts from which a judgment in favor of plaintiff might be based. The very reason that Rule 52 requires findings of fact is illustrated by the majority opinion. For the technical difficulties of finding a basis of fact for this judgment are many. Indeed, *such difficulties are insurmountable.*"

Earlier Judge Fee had said (R. 2239):

> "There are no findings of fact [by the Trial Court] which support the judgment of the Trial Court or the affirmance thereof by a majority of this Court. The cause should be remanded for this reason alone."

Thus Judge Fee has made it clear (1) that on the record it would be impossible to make a finding that would support a judgment for respondent and (2) that the Court of Appeals had no power to do so, that therefore it could not affirm the judgment, but at most could only remand for findings.

C. THE FUNCTION TO FIND FACTS IS IN THE TRIAL COURT, NOT THE COURT OF APPEALS.

Where a trial court fails to find on essential issues, the cause must be remanded.

R.C.P. Rule 52(a) provides that the trial judge "shall find the facts." That rule "was advisedly made mandatory * * *." 5 *Moore's Fed. Prac.* (2d ed.), p. 2657, fn. 21.

Where a finding has been made in the trial court, a Court of Appeals may set it aside where it is "clearly erroneous" and may reverse the judgment in consequence. But when a Court of Appeals does not have the benefit of an initial finding on a material fact by the trial court, it may not itself supply it.

"It is not the function of [an appellate court] to search the record and analyze the evidence in order to supply findings which the trial court failed to make." *Kelley v. Everglades Dist.*, 319 U.S. 415, 421; *Securities & Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 88. A reversal should follow failure to find at all on an issue held to be material. *Interstate Circuit Inc. v. United States*, 304 U.S. 55.

The Courts of Appeals have repeatedly so stated the law.[51]

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[51] E.g., *Waialua Agricultural Co. v. Maneja*, 178 F.2d 603, 607, 608 (9 Cir.): "It is not the function of an appellate court to make findings on its own account." "The absence of findings * * * leaves no pediment on which a judgment can stand"; *Jacuzzi Bros. Inc. v. Berkeley Pump Co.*, 191 F.2d 632, 638 (9 Cir.): ". . . the law does not commit that function to us, but solely the power to reverse if his findings be clearly erroneous"; *Helbush v. Finkle*, 170 F.2d 41, 42 (9 Cir.): Where a determination "would necessitate findings on questions on which the District Court has made no findings * * * such findings should be made by the District Court, not by this Court"; *Paramount Pest Control Service v. Brewer*,

There is an essential difference in the function of an appellate court and a trial court. As stated in oft-cited *Saginaw Broadcasting Co. v. Federal Communications Commission*, 96 F.2d 554, 559 (D.C. Cir.), an appellate court's function is to compare (1) rulings with the law and (2) findings with the record, not to extract findings from the record itself. When it has no specific finding before it, it has nothing to compare against the record and should reverse. So also *Commissioner v. Kolb*, 100 F.2d 920 (9 Cir.).

The vice of exploring the record to find facts *ab initio* is not only that it involves the appellate court in a new kind of task, but that it deprives the litigant of an opportunity to be heard. No proper machinery exists in an appellate court to settle findings in the first instance.

The Majority Opinion Sets Up a Novel and False Principle Concerning the Power of an Appellate Court.

The majority opinion disposes of the lack of findings to support its theory by saying that "Findings are not a jurisdictional requirement of appeal," and that an appellate court "may waive the defect on the ground that the error is not substantial in the particular case," if it feels able to find the facts itself (R. 2236). It supports this assertion by citing three cases, *Mayo v. Lakeland Highlands Canning Co.*, 309 U.S. 310; *Goodacre v. Panagopoulos*,

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170 F.2d 553, 554 (9 Cir.): "This Court of Appeals has no power *ab initio* to consider" issues on which no findings were made.

So also *Jones v. Waterman SS Corporation*, 155 F.2d 992, 997 (3 Cir.); *Kistler v. Gingels*, 171 F.2d 912 (8 Cir.); *Campbell v. Campbell*, 170 F.2d 809 (D.C. Cir.); *McClure v. O. Henry Tent & Awning Co.*, 184 F.2d 636, 639 (7 Cir.); L. Hand, J. in *Petterson Lighterage & Towing Corp. v. New York Central R. Co.*, 126 F.2d 992 (2 Cir.); *Girard Trust Co. v. Windt*, 178 F.2d 359 (2 Cir.); *United States v. Aluminum Co.*, 148 F.2d 416, 433 (2 Cir.); *United States v. Forness*, 125 F.2d 928, 942 (2 Cir.); *Ginsberg v. Royal Ins. Co.*, 179 F.2d 152, 154 (5 Cir.).

110 F.2d 716 (D.C. Cir.), and *Hurwitz v. Hurwitz*, 136 F.2d 796 (D.C. Cir.). This Court nowhere stated in the *Mayo* case that when a case comes up without findings on issues which the appellate court deems material, it may make them *ab initio*. Its opinion contained a statement that findings are intended to benefit appellate courts. That statement is converted by the court below into a declaration that if the appellate court decides to find the facts itself it may dispense with findings by the trial court.

In *Goodacre v. Panagopoulos* and in *Hurwitz v. Hurwitz*, there was no lack of supporting findings but merely informality or irregularity in the mode of expressing them.

VII.

The Court of Appeals Erred in Denying Petitioner the Right to Petition for a Rehearing In Banc

After decision below, petitioner filed a petition for rehearing in banc under 28 U.S.C., Sec. 46(c). Two of the three judges constituting the panel which heard the appeal struck the petition as "being without authority in law" (R. 2259-2260). Judge Fee, dissenting, suggested a "rehearing en banc of all the Circuit Judges" (R. 2262). Petitioner then filed a petition asking leave to reinstate the petition for consideration by the entire court (R. 2263-2282). This the court, in banc, denied, declaring that it "declined altogether to entertain petitions of litigants for such hearings" (R. 2295). Chief Judge Denman dissented (R. 2296 and 2313).

The main ground of the ruling is that once a case has been assigned to a panel of three judges, it is in their jurisdiction, and the remainder of the court has no power

to participate unless two of the three should vote to relinquish the case to the whole court. The other judges, the court said, "may not intrude themselves"; any petition for rehearing "must necessarily be treated as addressed to" the panel and "solely for [its] disposition," and if a majority of the panel denies the petition "that ends the matter" (R. 2294).

This decision, and the practice which it decrees, places the Ninth Circuit in conflict with the statute, with the holdings of this Court, and with the practice of the District of Columbia and Third Circuits.

CONFLICT WITH THE STATUTE.

While recognizing that a Court of Appeals has power to direct a hearing in banc initially, the court below held that the power is lost by an assignment to a panel so that there is no power to grant a *re*hearing in banc. The statute, 28 U.S.C., Sec. 46(c), draws no such distinction. It provides:

> "Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing *or rehearing before the court in banc* is ordered by a majority of the circuit judges of the circuit who are in active service."

CONFLICT WITH THE HOLDING OF THIS COURT.

The statute was occasioned by a conflict between the Ninth Circuit, which held that the court could not sit in banc and the Third, which held that it could (*Lang's Estate v. Commissioner*, 97 F.2d 867 (9 Cir. 1938); *Commissioner v. Textile Mills Corporation*, 117 F.2d 62 (3 Cir. 1940)). Upholding the Third, and rejecting the view of the Ninth, this Court held that hearings could be had in banc, *Textile Mills Corporation v. Commissioner*, 314 U.S. 326.

S. 1053 was then introduced in the 77th Congress to give more explicit expression to the procedure approved by this Court. The hearing on the bill shows that it was contemplated that litigants could petition for hearings in banc.[52] While not then enacted, the bill was adopted in substance as Section 46(c) upon revision of the Judicial Code in 1948. It "preserves the interpretation established by the *Textile Mills* case." (Reviser's note.)

Citing that case, this Court in *United States ex rel. Robinson v. Johnston,* 316 U.S. 649 (1942), on certiorari to the Ninth Circuit, remanded the case "for further proceedings, *including leave to petitioner to apply for a hearing before the court en banc.*" Thereby it necessarily construed the statute as giving to the litigant "authority in law" to file a petition for rehearing in banc and to the court power to grant it.

The Ninth Circuit had held in the *Lang* case that a court may not be composed of all the circuit judges of the circuit in active service, when there are more than three, because

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[52] Hearings before the Subcommittee on Judiciary on S. 1053, 77th Congress, 1st session.

"Senator Danaher: * * * On whose motion would the court assemble en banc? * * * Who is going to make a motion that the whole court sit on this case? The counsel in the case?

* * * * * * *

"Mr. Chandler: The counsel can make a suggestion of course." (p. 16)

Again:

"Senator Danaher: Judge Groner, do you gentlemen of the bench have any thought to give us as to how we are going to let a majority of the circuit judges decide * * * when they are going to convene the court en banc?

"Judge Groner: * * * My own thought in the administration of my own court would be that it would not be done unless counsel requested it, or unless the court of its own motion * * * deemed it advisable * * *." (p. 40)

that view of the law would "lead to grave difficulties of administration," since "then each judge may well have the right and the duty to demand his place in the hearing on each appeal" (97 F.2d at 870).

Since this Court thereafter held, and Congress thereafter declared, that there is power to sit in banc, it would follow that the other judges do have a right, and in a proper case the duty, to sit.

Despite this Court's decision in the *Textile Mills* case in 1941 and in the *Robinson* case in 1942, the Ninth Circuit has remained fixed in its view that a case becomes the exclusive jurisdiction of a particular panel of three judges once it has been assigned to them. While the form of its practice has varied, the substance has remained the same.[53]

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[53]In 1943, in **Crutchfield v. United States,** 142 F.2d 170, the senior circuit judge "refuse[d] to convene the court en banc *even to consider* the question of the jurisdiction of the court en banc to take over a case pending before three judges * * * either on the petition of the litigant or * * * a dissenting judge of the three-judge panel." The language and the italics are that of Judge Denman, the dissenting judge. The ground of the refusal was

> "that once the three judges so assigned by the whole court to consider the case have rendered judgment * * * only the setting aside of the judgment by two or more of the three judges participating in the decision permits a petition for a rehearing en banc." (p. 180)

In 1945, in ***Independence Lead Mines Co. v. Kingsbury,*** 175 F.2d 983, two judges in a panel of three denied a petition for rehearing in banc over Chief Judge Denman's dissent that two judges had no power "to act on a petition addressed to seven judges." In 1950, in ***Kronberg v. Hale,*** 181 F.2d 767, and in three later cases where the panel consisted of but one circuit judge and two district judges (***Freuhauf Trailer Co. v. Myers,*** 181 F.2d 1008; ***Northwestern Mutual Life Insurance Co. of Milwaukee v. Gilbert,*** 182 F.2d 256, and the order of January 30, 1952 in the present case), the panel struck a petition for rehearing in banc as "being without authority in law." And now, by the most recent decision herein, the court has announced a return to the practice of treating a petition for rehearing in banc as addressed to the panel alone.

CONFLICT WITH OTHER CIRCUITS.

Both the District of Columbia and the Third Circuits entertain and grant petitions for rehearing in banc. The practice of the District of Columbia Circuit is shown by a letter of Chief Judge Stephens, and citations therein, quoted in Chief Judge Denman's dissenting opinion (R. 2313), and by this Court's records in *Sawyer, Secretary of Commerce v. Dollar*, No. 247, October term 1951, pp. 52, 61, 62 therein.

THE RIGHT TO PETITION FOR A REHEARING IN BANC COMPORTS WITH REASON AND PRINCIPLE.

Commenting on *Independence Lead Mines Co. v. Kingsbury* (supra, footnote 53), 63 Harvard Law Review 1449 said that.

> "since the three judges here could not under § 46 have ordered a rehearing, their action in considering the petition seems singular" (p. 1451)

and

> "* * * fuller development of the rules governing the procedure by which the hearings are granted or denied seems both necessary and practicable. * * * perhaps formal petition of counsel, as in the instant case, is the most suitable method for initiating a hearing *en banc* in a particular case. * * * The petition should, it seems, be entitled to such consideration that denial of the petition results only when a majority of the individual judges are unwilling to grant it." (p. 1450)

After the decision below, Circuit Judge Pope expressed the view, similar to that of Chief Judge Denman's but contrary to that of the rest of the court, that the full court has power to grant a rehearing in banc but, contrary to

Chief Judge Denman, that a litigant is not entitled to petition for such action.[54]

A litigant must have the right to request a court to exercise a power which it possesses and to grant the kind of relief which the law empowers it to grant. Since hearings in banc can be ordered by a majority of the active circuit judges and only by them, a litigant must be entitled to have his request presented to them all for consideration and action. Two judges ought not to have the power to prevent the other five from even being apprised of the request. If two district judges are on a panel, they ought not to be able to prevent the circuit judges, alone qualified to pass on the question, from acting. The question is not, as stated below, whether a court may "be compelled on the petition of a losing party" to sit in banc (R. 2294), but whether the litigant may request the judges to do so, if they think it warranted in the particular cause.

THE RIGHT TO PETITION COMPORTS WITH FAIR AND EFFICIENT JUDICIAL ADMINISTRATION.

The court below also held that to entertain petitions for rehearing in banc would burden the court with overwork and thus nullify the object of the statute in permitting three judge panels (R. 2295). This same reasoning was stated by the same court in 1938 in the *Lang* case (97 F.2d at 870).

Without depreciating the apprehension of overwork, we submit that it should not lead to a total denial of the right of petition.[55] In many cases no petitions for rehearing are

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[54] *Bradley Mining Co. v. Boice*, 198 F.2d 790 (9 Cir. Aug. 27, 1952). This was stated to be Judge Pope's interpretation of what the court had held in the present case. We submit that it misconstrues that holding.

[55] Neither the District of Columbia nor the Third Circuit finds that recognition of the litigant's right produces an intolerable burden.

filed, and in still fewer are requests made for a rehearing in banc. Such a petition was here filed only because of the unusual combination of factors noted by Judge Fee in requesting the court to grant a rehearing in banc (R. 2262). Overwork may be a proper factor to consider in deciding whether to grant a petition in a particular cause. But the law, whose art is discrimination, should be able to discriminate between the few cases where such a rehearing is warranted and the many where it is not.

The device of having an appellate court sit in divisions is but the equivalent of having a number of coordinate intermediate appellate courts answerable to another superior to them. The propriety and necessity of permitting a petition to the whole court, where it sits in divisions, or to the higher court, is obvious, and the practice is widespread. Unless petitions for rehearing in banc are recognized, most circuits will contain not one but a multiplicity of Courts of Appeals with almost an infinity of opportunity for conflict between the views of the different panels. Seven judges can be constituted into 35 different panels of three. With District Judges sitting on the court, as here, there is the possibility of even more panels. If there is to be an opportunity to review their decisions, there must be a right to petition for rehearing in banc unless the burden is to fall on this Court in its certiorari jurisdiction.[56]

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[56] It has been argued that a judge should not be required to read long records in cases in which he has not sat in the original hearing. But a reading of a whole record should not ordinarily be necessary to pass on a petition for rehearing in banc, any more than to pass on a petition for certiorari, since the question presented is not the final decision but merely the desirability of consideration by the court, which should turn on the kind of issues presented, not the evidence.

A more extensive discussion of the error of the court below in denying petitioner the right to petition for rehearing in banc, and of the authorities bearing thereon, may be found in our petition for certiorari (at pages 7, 8, 27-30) and in our "Reply Brief in Support of Petition for Certiorari" (at pages 1, 2 and 14-23).

VIII.

Judgment Should Be Directed for Petitioner for the Full Amount of the Tax Savings

For the reasons stated in the preceding pages, we submit, the decision of the Court of Appeals should be reversed. And there is no reason why the cause should be remanded to the District Court for further trial or findings. On the undisputed facts and the findings already made by the District Court, overwhelmingly supported—indeed required—by the record, the cause should be remanded with directions to enter judgment for the petitioner for the amount of the unjust enrichment which the courts below found to be $17,201,739 (p. 4, supra).

Petitioner is entitled to the full amount of the unjust enrichment and not merely part thereof, for two reasons:

First: As shown in Part III of this brief, the purpose and rationale of the tax laws in permitting consolidated returns so require. Recovery by petitioner of the entire amount would be only an amelioration of the loss that made the savings possible, while retention by respondent of any part would be a sheer windfall.

Second: The principles discussed in Part IV also establish petitioner's rights to the entire enrichment. In view of respondent's seizure and appropriation of petitioner's

rights, its stubborn refusal to recognize that it was a fiduciary for petitioner, its callous disregard of petitioner's equities and the rights of petitioner's shareholders, a court of equity should not be called upon now to determine how the parties might have allocated the tax savings if respondent had respected petitioner's rights, had advised it of what was proposed to be done and of the legal and economic consequences,[57] and had given petitioner the opportunity to make a bargain. The opportunity was denied, and "the price of denial" should be that respondent now account for all the benefits. *Meinhard v. Salmon,* 164 N.E. 545, 547, 249 N.Y. 458 (Cardozo, C. J.).

CONCLUSION

We respectfully submit that the judgment of the Court of Appeals should be reversed with direction to remand to the District Court for entry of judgment in favor of petitioners and against respondents.

Dated: San Francisco, California, November 20, 1952.

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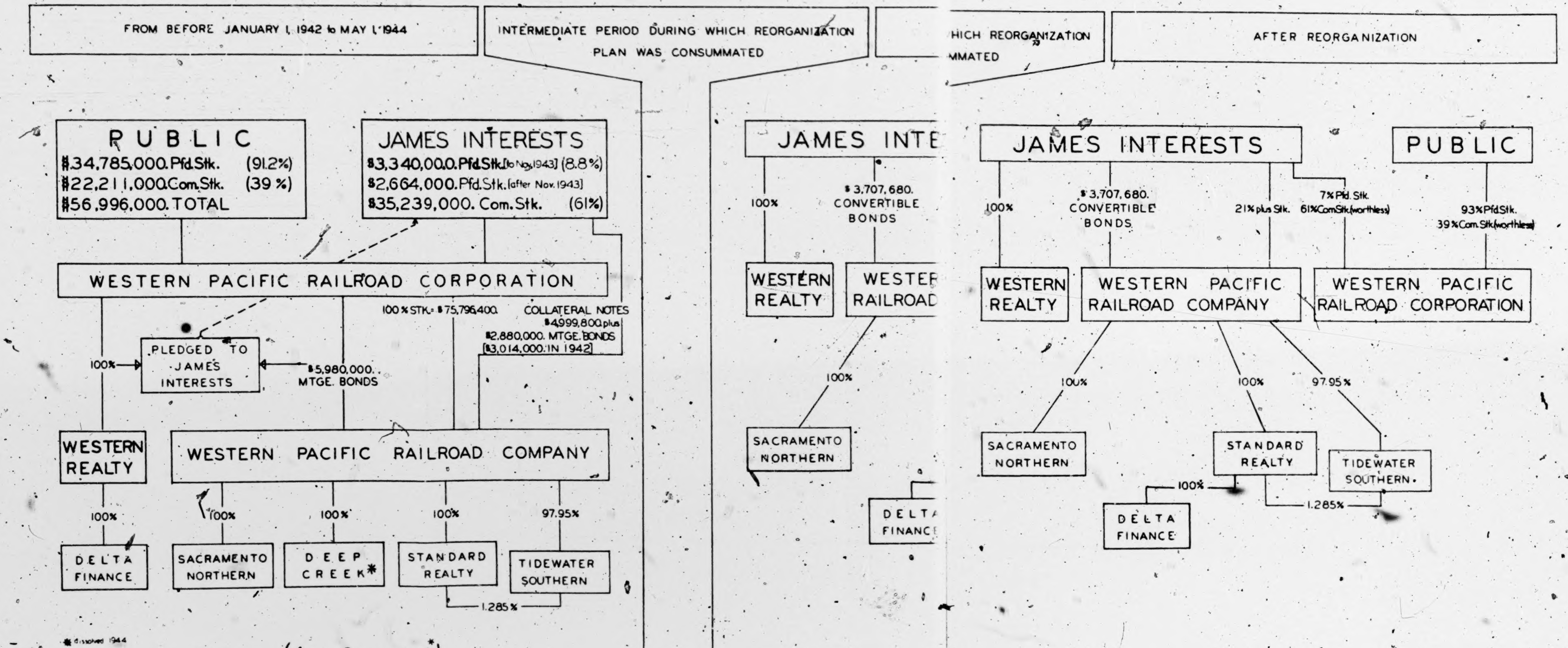
[57] "If dual interests are to be served, the disclosure * * * must lay bare the truth, without ambiguity or reservation, in all its stark significance." *Wendt v. Fischer,* 154 N.E. 303, 304, 243 N.Y. 439 (Cardozo, J.).

(Appendices follow)

for tax purposes the net result of its sales department, the net profit or loss on its manufacturing activities, the net profit or loss on its investments, or the net profit or loss on each and every one of its agencies. Such a requirement would be so absurd as to appear on its face ridiculous, and it is only necessary to state the case of a single corporation to demonstrate its absurdity. It is no more absurd, however, when applied to the different departments of a single corporation than it is when applied to the subsidiary corporation of a single unit. For instance, if a single corporation has a manufacturing department and a sales department, and we regard it as absurd to separate them for tax-accounting purposes, it is equally absurd when dealing with two subsidiary corporations, one of which does the manufacturing and the other one of which does the selling, to claim that theoretically they are two separate entities, when as a matter of fact, they are both engaged in a common, inseparable enterprise."

CORPORATE RELATIONSHIPS



P. Ex. 1 (As Corrected*)

* P. Ex. 1 inadvertently showed Delta Finance as dissolved in 1944, whereas it was Deep Creek that was dissolved.

APPENDIX ONE

STATUTES INVOLVED

1. Internal Revenue Code, Section 141.

"(a) *Privilege to file consolidated income and excess-profits-tax returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. * * *

"(b) *Regulations.* The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits tax returns and of each corporation in the group, both during and after the period of affiliation,

may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. * * *

"(c) *Computation and payment of tax.* In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 204 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. * * *

"(d) *Definition of 'affiliated group'.* As used in this section, an 'affiliated group' means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

"(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

"(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

"As used in this subsection, the term 'stock' does not include nonvoting stock which is limited and preferred as to dividends.

* * * * * * *"

2. Internal Revenue Code, Section 730.

Relating to excess-profits tax, this is similar to Section 141.

3. Internal Revenue Code, Section 23.

"*Deductions from gross income.* In computing net income there shall be allowed as deductions:

* * * * * * *

"(g)(2) *Securities becoming worthless.* If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

* * * * * * *

"(4) *Stock in affiliated corporations.* For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

"(A) At least 95 per centum of each class of its stock is owned directly by the taxpayer; and * * *"

4. Internal Revenue Code, Section 52.

"* * * In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make

returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control."

5. Title 28 U.S.C., Section 46(c).

"Cases and controversies shall be heard and determined by a court or division of not more than three judges, unless a hearing or rehearing before the court in banc is ordered by a majority of the circuit judges of the circuit who are in active service. A court in banc shall consist of all active circuit judges of the circuit."

6. R.C.P., Rule 52(a).

"In all actions tried upon the facts without a jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; * * *"

7. Treasury Regulation 104.

"Sec. 23.1. *Privilege of Making Consolidated Returns.*

"(a) Sections 141 and 152, as amended, give to the corporations of an affiliated group the privilege of making a consolidated return for the taxable year in lieu of separate returns. This privilege is given, however, for taxable years beginning after December 31, 1941, upon the condition that all corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to these regulations, and any amendments thereof duly prescribed prior to the last day prescribed by law for the filing of the return; and the making

of the consolidated return is considered as such consent. * * *"

Sec. 23.15(b): *Liability of a Corporation in Bankruptcy or Receivership.*

"If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the District of Columbia, then the liability under paragraph (a) of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed."

Sec. 23.16(a): *Scope of Agency of Common Parent Corporation.*

"Except as provided in paragraphs (b) and (c) of this section—

"The common parent corporation shall be for all purposes, in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. * * *"

8. Treasury Regulation 110.

Relating to excess profits tax, this is similar to T. R. 104.

APPENDIX TWO

In the Report of the Senate Finance Committee (70th Congress, 1st Session, Senate Report 960), the following appears (p. 8):

> "* * * The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. Unless the affiliated group as a whole in the conduct of its business enterprise shows net profits, the individuals conducting the business have realized no gain. The failure to recognize the entire business enterprise means drawing technical legal distinctions, as contrasted with the recognition of actual facts. The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies. It would be just as unreasonable to demand that an individual engaged in two or more businesses treat each business separately for tax purposes. Much of the misapprehension about consolidated returns will be removed when it is realized that it is only when the corporations are really but one corporation that the permission to file consolidated returns is given, and that no ultimate advantage under

the tax laws really results. The present law permits the filing of consolidated returns only where one corporation owning at least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts."

Vol. 69, Congressional Record, p. 653, contains the following discussion:

"Mr. Tilson. * * * Let us remember that the provisions of the bill are applicable only where corporations are, in effect, but one corporation, 95 per cent ownership being required. In most cases there is an ownership of 100 per cent. The interests are the same.

"The ability to pay must be governed by the net income of the entire group. Computing the income of each separate corporation is but the basing of an income tax upon paper profits. Our income tax law should be based as nearly as possible upon income actually realized.

"Group organization of corporations, all owned ultimately by the same stockholders, has been developed by modern business for perfectly legitimate reasons, among them being separate accounting for the various parts of an enterprise and the desirability and frequently the necessity, of creating an independent corporation for the purpose of carrying on a particular part of the business, both at home and abroad. The mere fact that by a legal fiction these are separate entities should not obscure the fact that they are in reality one and the same business, owned by the same individuals, and run as a unit. To refuse to recognize this fact and to compel for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report

In the Supreme Court of the United States

October Term, 1952

No. 150

Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver,

Petitioners,

vs.

Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, The Western Realty Company, The Standard Realty and Development Company and Delta Finance Co., Ltd.,

Respondents

PETITIONER'S REPLY BRIEF

Respondent presents several affirmative arguments why, even though petitioner's claim be good on the merits, respondent may nevertheless defeat it. Before answering these arguments, we first point out the fallacies of respondents' contentions on the merits.

I

PETITIONER IS ENTITLED TO RECOVER ON THE MERITS

Respondent's case may be summarized in two contentions:

1. There is a "general rule", applicable here, that where consolidated returns are filed, a "loss" company is not

entitled to any consideration or compensation from the "gain" companies whose taxes are reduced by the offset of the loss (Br. 42).

2. Petitioner was under a duty to join in consolidated returns and give its loss to respondent (Br. 65).

No court decision supporting either contention is cited.

While respondent also argues that it was not a fiduciary of petitioner and did not cause petitioner's officers to file the consolidated returns (notwithstanding the trial court's finding to the contrary), it asserts that these facts are irrelevant; and it bluntly stands on the proposition that, even though it was a fiduciary, it is under no duty to account, for "petitioners have no claim, whatever the conduct of the parties may have been" (Br. 24).

A. Respondent Ignores the Basic and Unique Fact of This Case, the Severance of the Economic Unity

Respondent's arguments, particularly those about a "general rule", are permeated by its refusal to recognize the unique fact of this case, namely, that this Court's affirmance of the I.C.C. plan severed the economic unity, and that when the returns were filed petitioner had no economic interest whatever in respondent.[1]

This case does not fall in the customary pattern of corporate affiliation. Here the loss which respondent used

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[The symbol "O.B." refers to petitioner's opening brief. "Br." refers to respondent's brief.]

[1] Respondent's answer to the unique fact of the case is no more than a denial that there was a severance of the economic unity, plus a mere assertion that the fact is without significance (Br. 59-62). It contends that confirmation of the Plan "severed nothing" (Br. 59) because the "affiliation" continued to April 1944. But that continued "affiliation" was technical only. As for its argument that " 'economic unity' in matters of consolidated returns is a false factor" (Br. 60), we refer to O. B. 75 where we anticipated it.

to satisfy its tax liability was its former parent's loss of ownership of the respondent itself.

The "paradox" was recognized by respondent's tax counsel, who were the first to describe it, in their letter which first suggested the possibility of using the loss, where they said, "This is commented on rather than suggested as of certain value, since it is paradoxical to compute a loss upon the operating company's stock which, through the medium of consolidated return reporting, could be used to nullify the very income of the affiliate whose stock had become worthless." (R. 591; O.B. 19). The unique situation was recognized by the trial court, which was moved in its opinion to characterize the tax savings as "amazing and undeserved" (R. 276). How could there be a duty to give respondent an "amazing and undeserved" benefit?

This failure to recognize the severance of the economic unity and the paradoxical nature of the result vitiates respondent's argument based on "past practice" of the parties. It also vitiates its argument founded on alleged practice of "the business community" (Br. 41). If such a practice exists, it relates to a continuing economic unity where the parent benefits by whatever benefits any affiliate. The argument was repeatedly advanced at the trial, but the elaborate evidence offered by respondent to support it was excluded by the trial court, which said (R. 1379):

> "The question would never arise under the general business practice, because I do not think you would ever have any litigation. Absent the kind of situation that you have here between companies that were free agents to agree with one another to file this type of return. Here you have a situation where a third party, a new party, is getting the benefit of this tax situation. * * * the problem that is presented by it is entirely different from what might happen in the ordinary business relationship of parent and subsidiary

companies, where you have not the interposition of reorganization proceedings and all that they entail."[2]

This case involves no general question of how losses and savings should be shared between affiliated corporations. It involves the loss to the parent of its ownership in its subsidiary, thus bringing about a severance of the economic unity then and there so that the parent can no longer achieve the benefits of the tax savings through its continued ownership, and where, in the words of Judge Fee, there must be another method of applying the tax remission to the loss that gives rise to it (R. 2248).

Respondent's same basic fallacy vitiates its assertions about the alleged "precedents" (Br. 43-49), including its references to an investigation by the Federal Trade Commission in the late 1920's of utility holding companies, the enactment 8 years later of the Public Utility Holding Company Act of 1935, and Rule U-45 issued thereunder by the Securities and Exchange Commission.

In our opening brief we anticipated respondent's discussion of Rule U-45 of the S.E.C. and of the S.E.C. accounting release. There is a significant lesson to be drawn from the action of the S.E.C. under its rule, but it is the reverse of what respondent contends. When an affiliate's tax savings resulting from the use of another affiliate's loss could not or might not reach the party suffering the loss through ordinary channels, as by way of dividends or increase of its equity, the S.E.C. has considered it equitable that the benefit of the tax savings be passed directly to the party who suffered the loss. (See discussion in O.B., pp. 68-71)

The Federal Trade Commission investigation related to gas and electric holding companies and practices prevail-

[2] This is not the only instance where respondent's brief makes assertions on the basis of evidence offered by it but excluded by the trial court. Other instances appear at Br. 19, 88 and 89.

ing within groups in which there was a continuing economic entity. What concerned the F.T.C., so far as anything here involved is concerned, was the abuse of accounting practices as the result of which amounts paid as or in lieu of federal taxes were added to operating expenses to increase rates which then redounded to the benefit of the continuing parent.[3]

Respondent asserts that Treasury rulings "assume and provide" for a pro rata allocation of the tax "without tax saving payments" (Br. 46). Nothing could be farther from the fact, and the provisions of the various revenue acts which it cites are the very ones we referred to as recognizing the propriety of agreements between affiliates respecting apportionment (O.B. 126). For instance, Treasury Regulation 104, Sec. 23.15(b), which covers the liability of a corporation in bankruptcy, provides that "the liability * * * of each such member of the group * * * shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, *agree upon* * * *"

For the protection of the Treasury the regulations list certain circumstances wherein intra-group agreements are not recognized for certain purposes.[4] The very specifica-

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[3] The Commission felt that the "amounts paid as federal income tax should be deducted from the net income on which the tax was calculated" and not treated as an expense of operation (Br., App., p. 8, 3rd paragraph), and it condemned certain accounting procedures because they resulted in "an inaccurate recording of the true cost of operations of the electric and gas operating companies" (Br., App., p. 7, end of 1st paragraph). All this is irrelevant to the present case.

[4] For certain purposes it is necessary to determine earnings and profits available for dividends, and to this end taxes chargeable to each affiliate must be determined. For this calculation the Treasury requires the consolidated tax to be apportioned in a certain manner.

Respondent refers to the regulation that, if a parent has reduced its own tax by use of a subsidiary's loss, the base at which the parent holds

POSITIONS HELD BY OFFICERS, DIRECTORS AND COUNSEL OF THE W.P.R.R. CORPORATION WITH W.P.R.R. COMPANY AND TRUSTEES, THEIR COMPENSATION AND SOURCE THEREOF DURING THE PERIOD JUNE 1, 1943 TO OCT. 10, 1946.

	CORPORATION	COMPANY and TRUSTEES	
WHITMAN, RANSOM, COULSON & GOETZ (ROBT. E. COULSON & JAMES K. POLK)	TAX COUNSEL	TAX COUNSEL DIRECTOR (Coulson) from 12-28-44 COUNSEL for REORGANIZATION COM. MEMBER REORGANIZATION COM. (Coulson) to 3-28-46	TOTAL OF $149,325
SCHUMACHER	DIRECTOR	CH. EXECUTIVE COM. to 12-28-44 DIRECTOR to 12-28-44 TRUSTEE to 12-31-44	PENSION from 5-1-45 $15,000 PER YEAR From 5-1-45 $3000 PER YEAR
CURRY	PRESIDENT TREASURER DIRECTOR	DIRECTOR & EXEC. COM. to 11-20-44 VICE PRESIDENT & ASST. SECT. & ASST. TREASURER to 4-30-45	PENSION from 5-1-45 TO 5-1-45 $11,700 PER YEAR From 5-1-45 $3000 PER YEAR
VALOUCH	VICE PRESIDENT & SECRETARY & DIRECTOR from 5-1-45 Secretary to Curry	Secretary to Schumacher & Curry ASSISTANT SECRETARY 12-4-44 to 4-30-45	Between $2640 & $2860 PER YEAR to 5-1-45

DIRECTOR from 5-1-45 ASSISTANT SECRETARY
Secretary to Curry 12-4-44 to 4-30-45

	CORPORATION	COMPANY and TRUSTEES	
SHEEHAN	DIRECTOR 2-15-44 to 10-10-46	SWITCHBOARD OPERATOR & RECEPTIONIST to 5-1-45	Between $1980 & $2344 PER YEAR
WIENKEN	SECRETARY to 5-1-45 DIRECTOR to 4-25-46	STENOGRAPHER to 5-1-45	Between $2880 & $3212 PER YEAR
PIERCE & GREER (NICODEMUS & CAMPBELL)	GENERAL COUNSEL DIRECTOR (Campbell) to 5-1-45	COUNSEL to 12-31-45	TOTAL OF $19,625.
OSBORN	DIRECTOR	DIRECTOR & EXEC. COM. to 11-20-44	
WOOD	DIRECTOR		
HATTON	DIRECTOR		

CLERK-DENVER RIO GRANDE WESTERN R.R. CO. IN OFFICE JOINTLY OCCUPIED WITH WESTERN PACIFIC R.R. CO.

P. Ex. 2A.

tion of these instances and purposes shows that for all other purposes the relations of the parties are left to be adjusted by agreement or, in the absence of an agreement, by appropriate principles of equity.

Nowhere does respondent show any practice or cite any case where the loss was that of the parent's stock interest in the subsidiary. The reason is obvious: in the first place, the use of such a loss was first authorized in October 1942; in the second place, this case is "paradoxical".[5]

B. There Is No Support for Respondent's Assertion That Petitioner Was Under a Duty to Join in Consolidated Returns and Give Its Loss to Respondent Gratis

The tax law, the statute and the regulations, impose no such duty, and all the decided cases make clear that a parent corporation is free to join or not to join in consolidated returns as its own interests dictate (O.B. 94-96). *Duke Power Co. v. Comm.*, 44 Fed. 2d 543, cer. den. 282 U.S. 903; *George A. Fuller Co. v. Comm.*, 92 Fed. 2d 72 (2 Cir.); *Trinity Building Corporation of New York*, 40 B.T.A. 1315; 65 *Harvard Law Review* 1257:

On what basis, then, does respondent rest the alleged duty? It lists five supposed reasons (Br. 65). Every one would be present if the parent had also gone into bankruptcy or receivership in another court, as in fact it later did, in 1949, in the Delaware Chancery Court (O. B. 4). Yet its

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the subsidiary's stock for determining capital gains or losses must be reduced accordingly. This recognizes the obvious fact that the parent has reduced its investment in the subsidiary by taking advantage of the loss. There is no provision for reduction of the base where a subsidiary takes advantage of a parent's loss, which is the present case. The regulation shows the Treasury's view of the rationale of consolidated returns to be exactly as we contend, namely, that the parent is the ultimate economic owner of the enterprise and the ultimate beneficiary of tax savings.

[5] Respondent, referring to the Interstate Commerce Commission, admits that the I.C.C. has never ruled on the treatment of consolidated returns, but asserts that it has "rejected tax savings claims" (Br. 48). The two cases cited are not remotely in point. Neither involved the use of one person's losses or tax credits to reduce taxes of another.